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**Capital Accumulation and
Stagnation:
a Veblenian-Kaleckian Approach to
the Portuguese Lost Decade**

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Abstract

The crisis of 2008 came at the end of a Lost Decade for the Portuguese economy, marked by low growth and investment rates, and rising indebtedness. The purpose of this dissertation is to find the structural causes behind this period of economic stagnation. Stagnation in mature capitalist economies has been the subject of a vivid academic debate within mainstream economics. In part one, I argue that, due to their neoclassical foundations, these approaches cannot understand stagnation as a systemic outcome of the evolution of capitalism. Heterodox approaches, on the other hand, present stagnation as the product of the historical and social process of accumulation and concentration of capital. This dissertation combines the core arguments of heterodox theories – namely Steindl’s and Kalecki’s – with insights from institutional economics – in particular Veblen –, to understand the strategies used by capitalists to promote the concentration and accumulation of capital in Portugal and their impact on economic stagnation. In part two, I make use of different methodologies and sources to examine the constitution and evolution of the Portuguese largest economic groups. I find that the historical process of accumulation and concentration of capital is not explained by the nature of individual entrepreneurs nor by the pure mechanics of production. It is an institutionally determined process, in which two elements play a crucial role: the banking sector and the State. In a broad perspective, policies, regulations and institutions create the structure of incentives – rents – that organises the functioning of capitalism in different historical moments. In the third part, I demonstrate that the Lost Decade is the result of the accumulation regime erected in the 1980/90s, which promoted the concentration of surplus in large companies — dominated by short-term pecuniary interests and inter-class conflicts, and unwilling to invest in the productive system.

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Table of Contents

1.	Introduction	12
1.1.	Motivation and Research Question	12
1.2.	Approach and structure	20
1.3.	Contribution	24
PART I: Literature Review and Theoretical Discussion.....		26
2.	A critique to the mainstream debate on stagnation	26
2.1.	Introduction	26
2.2.	The mainstream debate	27
2.3.	A critique to the mainstream debate.....	31
2.3.1.	Theories of money and the classical dichotomy	31
2.3.2.	Theories of capital and the Cambridge Controversies	37
2.3.3.	The mainstream debate revisited.....	42
2.3.3.1.	Wicksellian theories	46
2.3.3.2.	Supply-side theories	51
2.4.	Final Remarks	56
3.	Theories of stagnation lost in heterodoxy	57
3.1.	Introduction	57
3.2.	Historical Context	59
3.3.	Hansen's theory of secular stagnation: half exogenous, half Keynesian	62
3.4.	Keynes vs Schumpeter: to be or not to be a stagnationist.....	68
3.5.	Kalecki's theory of investment: going where Keynes did not	80
3.6.	Steindl's response to Kalecki's challenge.....	85
3.7.	The Monthly Review theory	89
3.8.	Some advances in Post-Keynesian and Kaleckian models	91
3.9.	Empirical research on stagnation tendencies and market power	95
3.10.	Final remarks.....	99
4.	An institutional approach to stagnation.....	101
4.1.	Introduction	101
4.2.	A definition of stagnation.....	103
4.3.	The political and institutional nature of capital.....	104
4.4.	Capitalist sabotage in Veblen and Kalecki.....	107
4.5.	Putting together the elements for an institutional approach to stagnation	114
4.5.1.	The historical process of accumulation and concentration of capital	116

Inheritance and family networks.....	117
Finance and capital markets.....	119
The State	120
4.5.2. Dialectics of sabotage and stagnation	122
4.6. Final remarks.....	125
PART II: Historical Background.....	128
5. From monarchy to the Carnation Revolution: the historical process of concentration and accumulation of capital through mixed conglomerates.....	128
5.1. Introduction	128
5.2. From 1820 to 1910: The Liberal Monarchy.....	131
5.3. From 1910 to 1950: unproductive accumulation under the fascist dictatorship	136
5.4. From 1950 to 1974: the great accumulation under the fascist dictatorship	142
5.4.1. Concentration policies.....	142
5.4.2. Financing constraints and strategies.....	145
5.4.3. Groups with industrial origins.....	148
5.4.4. Groups with financial origins.....	159
The Espírito Santo Group	159
Banco Borges & Irmão	163
Banco Português do Atlântico	167
Banco Fonecas & Burnay.....	168
Grupo Banco Nacional Ultramarino (BNU).....	171
5.4.5. Mixed Conglomerates	174
5.5. Final Remarks	176
6. Neoliberal Accumulation: the re-creation of a capitalist class in the European Union....	179
6.1. Introduction	179
6.2. From private to State-owned to private: concentration policies	180
6.3. Emergence of first private groups	183
6.4. Privatisation, liberalisation and stock markets: the same strategy	188
6.5. Final remarks.....	194
PART III: Stagnation in the Lost Decade	195
7. The Portuguese rentist economic structure.....	195
7.1. Introduction	195
7.2. A short presentation of the country's largest groups and their evolution	198
7.3. In the aftermath of privatisations — profitable private monopolies in the utilities sector	200

Petrogal/Galp – Amorim’s jackpot	200
Portugal Telecom – Espirito Santo’s cash cow.....	203
Cimpor – ‘lost in construction’	208
Electricidade de Portugal – profits from rents	211
7.4. In the aftermath of privatisations — profitable Public Private Partnerships	216
7.5. Banking Sector: concentration and expansion	221
7.5.1. Competition through concentration.....	221
7.5.2. Banking Groups.....	225
BPI – Banco Português de Investimentos	226
BCP – Banco Comercial Português	227
BES – Banco Espírito Santo	228
Banco Pinto & Sotto Mayor, Banco Totta, and Santander Totta.....	230
7.6. Non-banking sector: diversification and dependence	232
7.6.1. Construction and real estate activities.....	232
7.6.2. Retail, wholesale and distribution	238
7.6.3. Amorim and the Mello families: new fortunes, old fortunes and the central role of the banking system.....	240
7.7. Final remarks.....	244
8. Profits without investment in the Lost Decade.....	247
8.1. Introduction	247
8.2. Capital share, profits and investment in the non-financial corporate sector	250
8.3. Concentration in the non-financial corporate sector	253
8.4. Profits vs. investment – a problem of distribution	257
8.5. Finance vs. investment – the principle of increasing risk	264
8.6. Final remarks.....	276
9. Conclusions	280
The visible hand of the State in the historical process of capital accumulation and concentration.....	282
Stagnation: when the strategies become sabotage	288
10. References	292
Appendix	316

List of Figures

Figure 1 - Annual growth rates (%) of GDP and long-term averages.....	13
Figure 2 - Annual growth rates (%) of GFCF and long-term averages.....	13
Figure 3 - Relation between GFCF and Private Consumption price deflators.....	14
Figure 4 - Variation (%) of GFCF and Private Consumption price deflators	15
Figure 5 - – Industrial Production Index for Portugal.....	15
Figure 6 - Unemployment Rate (%).....	16
Figure 7 - Financial assets and liabilities,1994-2016.....	17
Figure 8 - Evolution of Stock Market capitalisation, GDP and GFCF, 1989 - 2016.....	18
Figure 9 - Summers’ theory and Krugman’s Liquidity Trap	49
Figure 10 - Bernanke’s Saving Glut theory	49
Figure 11 - Analytical framework.....	116
Figure 12 – Structure of empirical chapters	127
Figure 13 – CUF Group: corporate structure	155
Figure 14 – Champalimaud Group: corporate structure.....	156
Figure 15 – Espírito Santo Group: corporate structure	161
Figure 16 – Borges & Irmão Group: corporate structure	165
Figure 17 – Banco Fonecas & Burnay Group: corporate structure	169
Figure 18 – Banco Nacional Ultramarino Group: corporate structure.....	173
Figure 19 – Structure of mixed conglomerates	175
Figure 20 – Privatisations’ revenues	189
Figure 21 – PPP payments, 2003-2039	220
Figure 22 - Evolution of the banking system.....	226
Figure 23 - Gross value added in the construction sector vs. total economy, 1990-1995.....	233
Figure 24 – Gross value added in the construction and real estate sectors vs. total economy, 1995-2010.....	233
Figure 25 – Interest rates, 1990-2010.....	234
Figure 26 – Gross fixed capital formation in the construction Sector	235
Figure 27 - Investment and capital shares of GDP for the non-financial corporate sector	250
Figure 28 - GOS/GVA ratio for the non-financial corporate sector	251
Figure 29 - Profit and Capital Shares in the non-financial corporate sector	252
Figure 30 - Relation between GOS and GVA, 1996-2003	258
Figure 31 - Relation between GOS and GVA, 2004-2016	258
Figure 32 - Share of output and GOS, 1996-2003	259
Figure 33 - Share of output and GOS, 2004 - 2016	260
Figure 34 - Contributions to the variation of GOS and Output (%)......	261
Figure 35 - Relation between GFCF and GOS, 1996 – 2003	261
Figure 36 - Relation between GFCF and GOS, 2004 - 2016	262
Figure 37 - Contribution to the variation of GFCF (%)	263
Figure 38 - Relation between Net Income and Net Operating Income, 1995 - 2016.....	265
Figure 39 - Relation between Net Income and Fixed Assets, 1995 - 2016.....	266
Figure 40 - Evolution of Fixed Assets, 1995 - 2016.....	267
Figure 41 - The composition of Returns on Equity.....	268
Figure 42 - Annual change in ROE (%), 1995 - 2016.....	270
Figure 43 - Operating Effect, 1995 - 2016.....	270
Figure 44 - Other Financial Income Effect, 1995 - 2016	271
Figure 45 - Relation between dividends and GOS, 1977 - 2016.....	272

Figure 46 - Financing Effects, 1995 - 2016	274
Figure 47 - Debt Rate, 1995 - 2016.....	274
Figure 48 - Interest Burden, 1995 - 2016	275
Figure 49 - Tax Effect, 1995 - 2016.....	276

Table 1 - Current Stagnation Theories	44
Table 2 - Dividend Yield 1972.....	149
Table 3 - Main economic groups, 1985 - 1990	184
Table 4 - Lisbon Stock Exchange, 1977 - 2000	192
Table 5 - PPP projects 1995-2010.....	217
Table 6 - Market Shares of the five largest banks (C5)	224
Table 7 - Concentration measures, 1996 - 2003.....	254
Table 8 - Concentration measures, 2004 - 2016.....	254
Table 9 - Concepts of Profit and Loss Account	269

Appendix

Table Ap. 1 – Planos de Fomento [Development Plans]	316
Table Ap. 2 – Reorganisation of the nationalised banking sector.....	317
Table Ap. 3 – Reorganisation of the nationalised industrial sector	318
Table Ap. 4 – Largest banks in 1994	320
Table Ap. 5 – Largest non-banking corporations in 1994.....	321
Table Ap. 6 – Largest banks in 2000	322
Table Ap. 7 – Largest non-banking corporations in 2000.....	322
Table Ap. 8 – Largest banks in 2007	323
Table Ap. 9 – Largest non-banking corporations in 2007.....	324
Table Ap. 10 – Galp’s financial data, 2000-2008	327
Table Ap. 11 – Portugal Telecom’s financial data, 1995 - 2000	329
Table Ap. 12 – Portugal Telecom’s investments in the Espírito Santo Financial Group	332
Table Ap. 13 – Cimpor’s financial data, 1995 - 2010.....	334
Table Ap. 14 – EDP’s financial data 1997 - 2010	338
Table Ap. 15 – Schemes and modalities of PPP contracts.....	342
Table Ap. 16 – PPP by year, shareholder, investment and NPV	342
Table Ap. 17 – Largest construction companies by revenue 2000-2007	347
Figure Ap. 1 - Galp stock prices, 2006-2008	326
Figure Ap. 2 – Grupo Espírito Santo: corporate structure in 2014	346

List of Abbreviations

NMC	New macroeconomic consensus
BB	Banco Burnay
BBI	Banco Borges & Irmão
BCP	Banco Comercial Português
BES	Banco Espírito Santo
BESCL	Banco Espírito Santo e Comercial de Lisboa
BFB	Banco FONSECAS & Burnay
BLA	Banco Lisboa & Açores
BNU	Banco Nacional Ultramarino
BPA	Banco Português do Atlântico
BPI	Banco Português de Investimento
BPSM	Banco Pinto & Sotto Mayor
BSCH	Banco Santander Central Hispano
BTA	Banco Totta & Açores
CGD	Caixa Geral de Depósitos
CMVM	Comissão de Mercado e Valores Mobiliários [Portuguese Securities Market Commission]
CPP	Crédito Predial Português
CTT	Correios de Portugal
CUF	Companhia União Fabril
EBITDA	Earnings before interest, taxes, depreciation and amortization
EDP	Electricidade de Portugal
EIB	European Investment Bank
GOS	Gross operating surplus
GVA	Gross value added
INE	Instituto de Estatísticas de Portugal [Statistics Portugal]
LE	Large enterprise
MEC	Marginal efficiency of capital
NI	Net income
NNS	New neoclassical synthesis
NOI	Net operating income
P S	Partido Socialista
PPP	Public-private partnership
PSD	Partido Social Democrata
PT	Portugal Telecom
REN	Redes Energéticas Nacionais
ROA	Return on assets
ROE	Return on equity
SME	Small and medium enterprise
SNS	Sociedade Nacional de Sabões
TAP	Transportes Aéreos de Portugal
TFP	Total factor productivity

1. Introduction

1.1. Motivation and Research Question

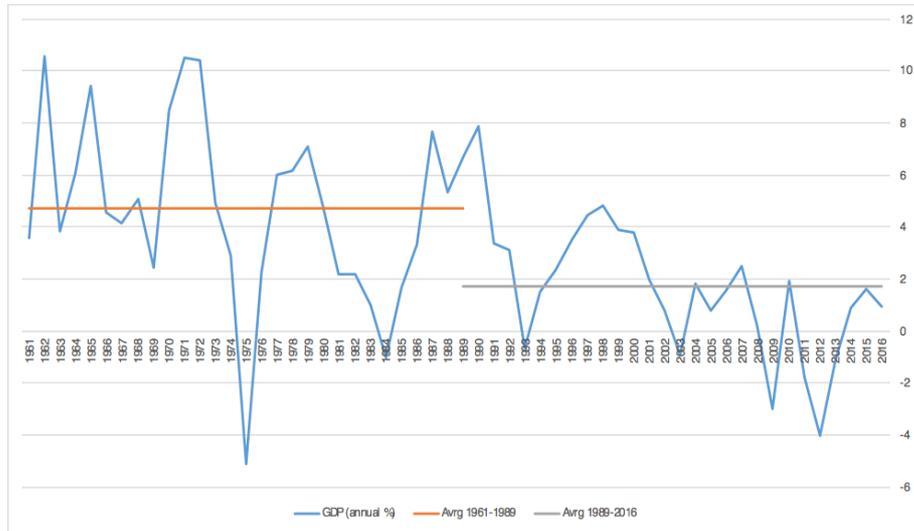
One decade after the financial crisis, mature capitalist economies have seen weak recoveries only. The focus on managing the Great Recession shifted to a different idea: something was structurally changing in capitalism, causing a long-term downward trend in economic growth and investment. This long-run trend was called *secular stagnation*.

Although it has been generally accepted that stagnation is a widespread phenomenon in the European Union, Japan and the US, its definition and causes are still in dispute. The search for a one fits all theory of stagnation, usually focused on monetary dynamics, tends to ignore that there are very different economies at stake, with their own historical and institutional idiosyncrasies. It also disregards the political character of capitalism and its inherent contradictions. Nevertheless, the secular stagnation debate created the context and opportunity to discuss – from a global and national point of view – the private capitalist accumulation process and its outcomes.

This dissertation, that aims to understand the particular expression of stagnation in Portugal and discuss its causes, was inspired by that debate and by the research topics it opened.

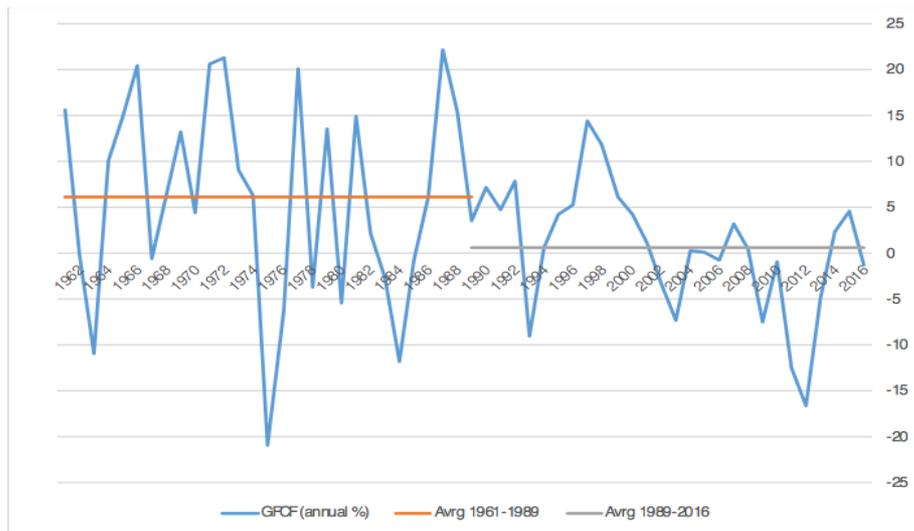
Figures 1 and 2 show gross domestic product (GDP) and gross fixed capital formation (GFCF) real annual growth rates between 1960 and 2016 and their averages for two sub periods, delimited by the European economic integration process that took place in the 1990s. The downward trend is clear in both cases: while the Portuguese economy grew at an average rate of 4,72%, with investment (GFCF) growing 6% between 1961 and 1989, in the subsequent period GDP and GFCF grew, on average, at a rate of 1,7% and 0,6%, respectively. This trend was particularly marked during the 2000s, when GDP growth rates averaged 1%, and GFCF -1%. Additionally, and contrary to previous decades, in this period the Portuguese economy underperformed the Eurozone. From the year 2000/2001 onwards, GDP/GFCF annual growth rates never surpassed the Eurozone average and this is the reason why the 2000s were labelled the Lost Decade.

Figure 1 - Annual growth rates (%) of GDP and long-term averages



Source: Ameco.

Figure 2 - Annual growth rates (%) of GFCF and long-term averages

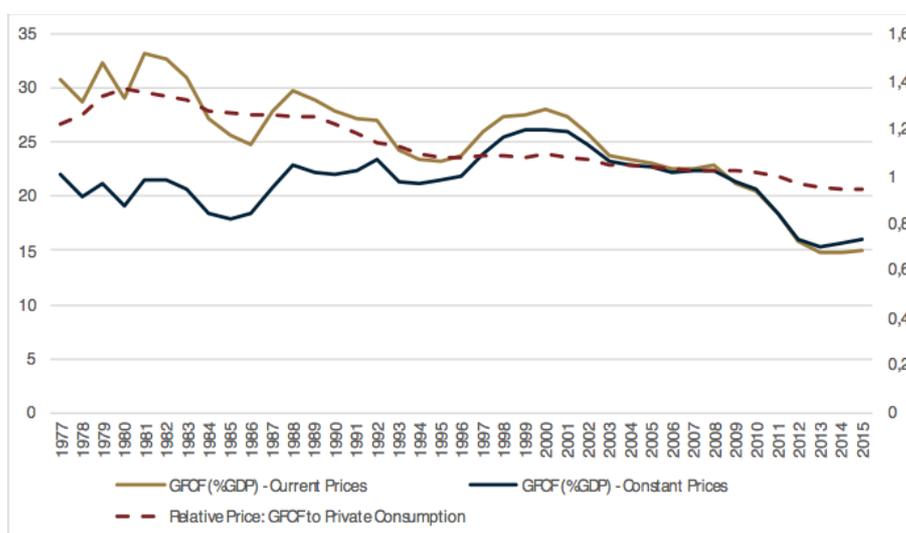


Source: Ameco.

The long-term downward trend in GDP and GFCF growth happened in tandem with a decline in the weight of investment on domestic product. A common explanation points to a relative decline in the price of investment goods due to technological innovation over the last decades (Eichengreen, 2015; Gordon, 1990; Thwaites, 2014). In the Portuguese case it has been suggested that the decline of investment prices also results from the liberalisation and European capital markets' integration processes.

Figure 3 confirms the decline in the ratio of fixed investment to private consumer price deflators. Until the mid 1990s, the evolution in relative prices explains the different behaviours in terms of the share of investment in GDP in constant and current prices. Instead of a decline (from 31% to 28% between 1977 and 2000) in current prices, there was an increase (from 22% to 26%) in the same period in real terms. However, starting in the second half of the 1990s, the effect of relative prices stabilises and, after the 2000s, both measures start declining sharply, from 28% and 26% to 15% and 16%, respectively, whether considered in constant or current values.

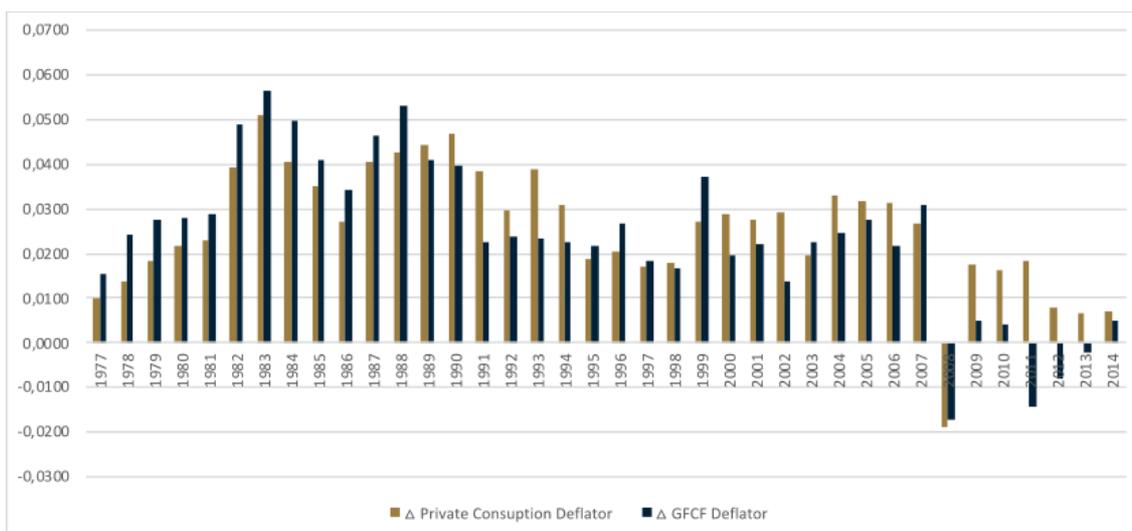
Figure 3 - Relation between GFCF and Private Consumption price deflators



Source: *Banco de Portugal* long-term series. Left Axis - GFCF in % of GDP at current prices and constant prices. Right Axis – GFCF price deflator/private consumption price deflator.

The breakdown in the relative price ratio (Figure 4) shows that there was, in fact, a decline in the price of investment goods relative to consumption in the first years of the 1990s, followed by a similar adjustment in consumption prices with a three years lag. After that, the changes in the deflator for GFCF do not show any particular trend.

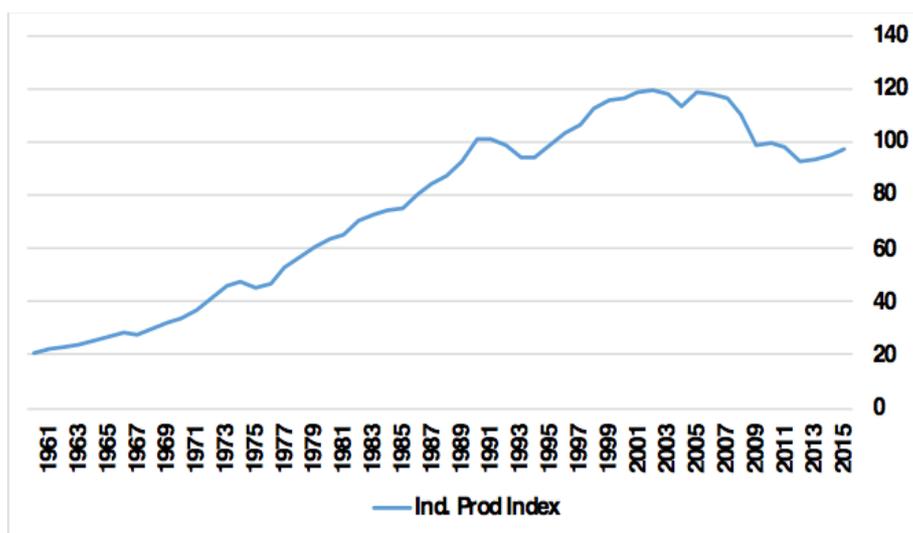
Figure 4 - Variation of GFCF and Private Consumption price deflators



Source: *Banco de Portugal*, Quarterly series for the Portuguese economy.

These results challenge the decline in investment goods price argument to explain investment behaviour. Furthermore, price effects do not explain the downward trend in real GFCF growth rates, or the stagnation in the industrial production index after the year 2000, as shown in Figure 5.

Figure 5 - Industrial Production Index for Portugal

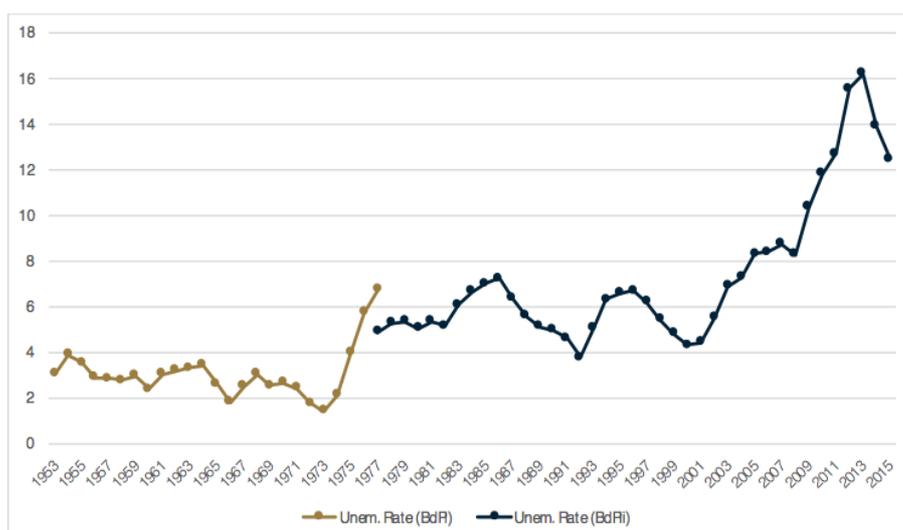


Source: Ameco. Note: Index number (2010=100) and excluding construction.

Mostly from the year 2000 onwards, these downward tendencies in GDP and GFCF were followed by rising levels of unemployment, as shown in Figure 6. In order to obtain a long-term perspective, it was necessary to resort to two different non-compatible series

provided by the *Banco de Portugal* [Bank of Portugal]. Notwithstanding its cyclical behaviour, it is clear that an upward trend started in 2001 and lasted throughout the 2000s. In 2007, before the onset of the financial crisis and the Great Recession, unemployment had already reached unprecedented levels, above 8%.

Figure 6 - Unemployment Rate (%)



Source: *Banco de Portugal*, Historical series about Portuguese economy after World War II (BdPi) and to the Quarterly series for the Portuguese economy (BdPii).

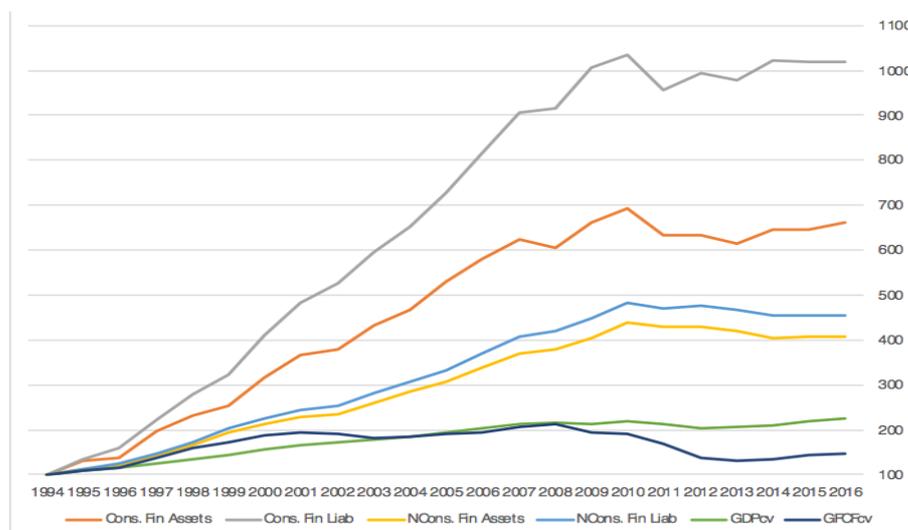
The Portuguese disappointing performance in the Lost Decade refutes theories such as the optimum currency areas theory, as well as neoclassical growth theories, that present convergence as the natural outcome of the free movement of capital flows in search of higher returns: ‘To the extent that they are countries with higher expected rates of return, poor countries should see an increase in investment’ (Blanchard & Giavazzi, 2002, p.148).¹

Portugal did not see an increase in investment with the European economic and monetary integration but experienced an impressive accumulation of financial assets and liabilities, as shown in Figure 7. The non-consolidated data is particularly relevant in the sector of non-financial corporations, where consolidation conceals the real level of balance sheet debt that must be refinanced. In comparison to GDP, between 1994 and 2007, consolidated financial liabilities increased from 63% to 285%, and non-consolidated financial liabilities from 497% to 1004%. National Accounts reveal three important trends: i) rising importance of financial assets and liabilities relative to GDP and

¹ See also Obstfeld & Rogoff (1994).

investment; ii) increase in overall indebtedness, given by the growing negative difference between the evolution of financial assets and liabilities on a consolidated basis; and iii) heavy stocks of non-consolidated financial assets and liabilities relatively to GDP and GFCF, suggesting alarming levels of intra-sector indebtedness.

Figure 7 - Financial assets and liabilities, 1994-2016

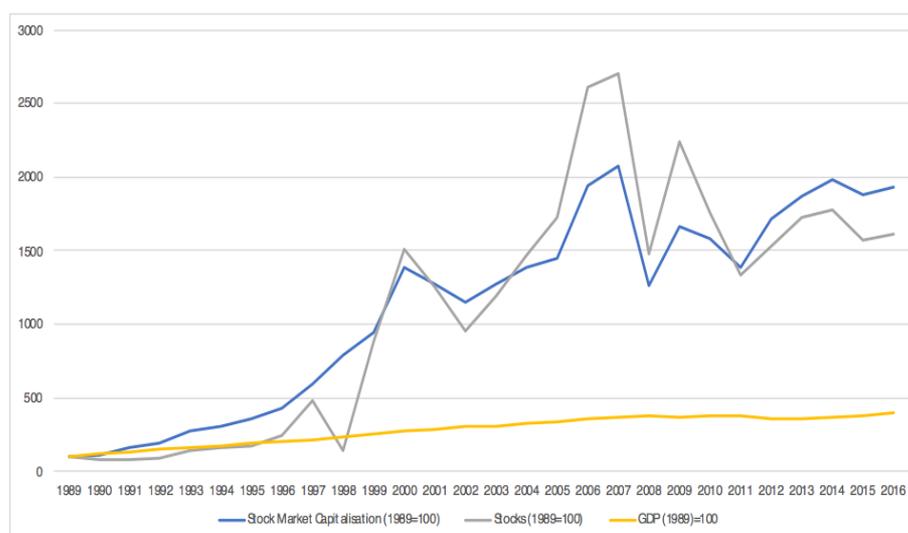


Source: *Banco de Portugal*, National Financial Accounts. Index number (1994=100)

Higher levels of debt have been closely related to a long-term rise in corporations' market value, either measured as the current market price of financial assets, as reported in Figure 7, or through the market capitalisation of the Lisbon Stock Exchange, presented in Figure 8. Once again, the difference in the relative evolution of corporate market values as compared with the market value of GDP is striking, mostly during the 2000s.²

² This evidence has been noted by Summers (2016).

Figure 8 - Evolution of Stock Market capitalisation, GDP and GFCF, 1989 - 2016



Source: *Banco de Portugal*. Index number (1989=100)

The increase in the market values of financial corporate assets indicates that, at least for the largest listed companies and their shareholders, profits have increased in the past twenty years, not only in absolute terms but also in relation to production.

To summarise, there are two empirical regularities regarding the Portuguese economy that deserve explanation:

- i. Lower long-term average rates of GDP and GFCF growth, particularly in the 2000s;
- ii. Low investment levels relative to asset valuation and indebtedness.

These regularities fit into the broad debate about what seems to be an endemic tendency of mature capitalist economies towards low growth, low investment, lack of innovation and economic dynamism.

Larry Summers offered an important contribution to the discussion by resuscitating one expression that had long been restricted to heterodoxy, secular stagnation. Within the mainstream economics, different contributions tried to fit this concept into the existing theory, giving it a new meaning. According to these views, secular stagnation is mostly a monetary phenomenon: a combination between a downward shift in trend output and a negative natural interest rate that keeps the real output far from its potential (Baldwin & Teulings, 2014).

In the first chapters of this dissertation I argue that, because these theories are ultimately grounded on flawed neoclassical theoretical foundations, their stagnation principle can only be exogenous – technology, demography – or reliant on highly abstract concepts – the natural interest rate. Either way, these attempts to explain and solve stagnation ignore the elephant sitting in the room: the politically and institutionally determined structure of mature capitalist economies.

The historical debate on stagnation, started by Hansen and developed mostly by Kalecki and Steindl, and by Sweezy (also referred as the Monthly Review theory) afterwards, avoids the common neoclassical parables, by placing the issue of stagnation within the social evolution of capitalism. The main argument is that the concentration and accumulation of capital generates stagnationist tendencies or inevitable crises. There are many roads to this argument, but most focus on the detrimental effects of a maldistribution of surplus in favour of large oligopolies or companies with market power. These conglomerates – the result of the inherent concentration tendencies of capitalism – do not invest in proportion to their accumulated surplus and become increasingly dependent on systemic debt to realise profits. Smaller companies, on the other hand, do not ensure a sufficient proportion of profits to guarantee the desired investment levels.

Hence, heterodox theories of stagnation are essential to understand the problem of lack of investment and growth in the presence of high indebtedness. However, their framework, based primarily on price markups, displays two weaknesses. The first is that it often overlooks the complex political and institutional dynamics underpinning the constitution of market power. The second, found mostly in Hansen and Steindl's theories, is that it opposes the existence of oligopolies to some ideal free enterprise system, which is far from being a feasible outcome of the capitalist organisation.

I believe, however, that such weaknesses are not due to ignorance or lack of awareness of these social and political dynamics. They are the downside of the effort to provide an abstract general economic theory, grounded on more realistic assumptions about the functioning of market economies.

This dissertation aims to fill these gaps, by combining heterodox theories of stagnation with the theoretical insights of Veblen's institutionalism, and also recent development studies. These elements are the foundations of the proposed historical and institutional approach to the study of the Portuguese Lost Decade. To be clearer, the purpose is to

discuss the specific process of capitalist accumulation and concentration of market power that led to the Lost Decade. This institutional approach to stagnation in Portugal unfolds in two research questions: i) *what were the specific strategies used by capitalists to promote the concentration and accumulation of capital in Portugal?* ii) *In what ways did those strategies contribute to low economic growth, low fixed investment and indebtedness in the Lost Decade?*

1.2. Approach and structure

This dissertation is divided in three parts. The first explores the existing literature on stagnation and sketches the theoretical framework for an institutional approach to stagnation in Portugal. The second part provides an historical account of the accumulation and concentration strategies in Portugal, necessary to understand the prevailing structure of ownership in the 1990s and 2000s. Finally, the third part analyses the ways in which the accumulation and concentration strategies of the Portuguese capitalist class contributed to the Lost Decade.

Part one comprises three chapters. Chapter 2 provides a critical review of the mainstream debate instigated by Summers in 2013. The different contributions are organised in two groups: Wicksellian theories, focussed on monetary aspects surrounding the natural interest rate and the role of monetary policy; and supply side theories, related to finding the real aspects behind the downward tendencies affecting the potential output.

These theory groups, as well as the different stagnation principles they put forward, are critically analysed in the context of two ground-breaking theoretical debates in the history of economics - classical dichotomy and capital controversies. It is argued that these approaches rely on flawed theories of money and capital and, therefore, on flawed methodological principles, such as methodological individualism, the belief in a systemic stability and a non-credit money view. Furthermore, these approaches share a general disregard for the specific institutional and political processes underpinning economic events.

Chapter 3 explores the historical stagnation debate, disregarded by mainstream contributions. The review opens with Hansen's seminal theory of secular stagnation, followed by an attempt to determine the existence of an implicit theory of stagnation in Keynes thought, as suggested by Schumpeter. Keynes' theory of declining marginal

efficiency of capital is analysed through the lenses of Kalecki's investment theory, with particular emphasis on the principle of increasing risk and degree of monopoly. Both concepts are developed in Steindl's theory of stagnation in mature capitalism. The Monthly Review theory of stagnation in the context of monopoly capitalism is also considered, with a special focus on the use and integration of Veblenian concepts. The chapter ends with a review of some post-Keynesian and Kaleckian developments as well as the most recent empirical investigations on capital concentration and its macroeconomic effects.

These perspectives are diverse but, in general, they avoid the confinement of neoclassical parables regarding money and emphasise the political nature of the economic process. With some exceptions, signalled along the discussion, historically, stagnation has been conceptualised as an endogenous phenomenon. The general idea, adopted by Robinson, Steindl, Kalecki or by the Monthly Review, is that companies with market power are able to set markups regardless of the phase of the economic cycle. Due to that capacity, these companies accumulate larger proportions of surplus in relation to their investment intentions, causing an overall slowdown of fixed investment and, therefore, of aggregate demand. This tendency can be overcome with external demand boosts, coming from financial activities or State investments, that ensure the realisation of that surplus into profits.

It is argued that although these theories provide a useful framework to unveil the causes of stagnation, they could benefit from the contributions of a more institutional approach. In other words, what is needed is an explanation of the concrete mechanisms that allow the formation and maintenance of market power, as well the specific links between the action of conglomerates, following their accumulation and concentration strategies, and investment and economic growth. The operation under excess installed capacity identified by Steindl is one of those links, but not the only one.

The role of chapter 4 is to provide that complementary framework, inspired by 'The Political Aspects of Full Employment' (Kalecki, 1943), in which Kalecki suggests that the political strategies laid down by capitalists to maintain their power can be growth and investment damaging. At this stage, one conceptual problem emerges: how can the accumulation of capital (power of capitalists) be damaging to the accumulation of capital (fixed capital)? To disentangle this confusion, originated in the different conceptual uses

of the term *capital*, one needs to return to the capital controversies, but this time to the first round of debates, between Veblen and Clark.

Veblen argued that, far from a mere stock of physical goods, the substance of capital is power. Its form, or appearance, however, is always money. The true purpose of capital is not to allow capitalist consumption, or investment, but to control the process of social reproduction. Thus, accumulation does not mean the enlargement of a stock of fixed assets, but the concentration and accumulation of capitalised wealth and power. Depending on the prevailing structure of incentives, in some historical periods the capitalist drive for accumulation and concentration matches the development of the productive system; however, in some occasions a counterproductive accumulation process emerges, as the pecuniary and strategic interests of the capitalist class damage economic stability and welfare. Veblen has named this damaging effect as *sabotage*, and that concept is reinterpreted to bring together institutional and economic heterodox stagnation theories.

It should be noted that it is not my intention to provide a moral or ethical judgement of capitalism. Sabotage, as other imported concepts from institutional economics, is used to address the impersonal and inherent dynamics of the capitalist system that govern individual behaviours towards a systemic outcome.

It is now possible to outline the main hypotheses underpinning this dissertation.

At the very beginning is the idea that the accumulation of capital occurred in parallel with a process of concentration of capital. In classical economics terms, recovered in heterodox theories of stagnation, this is the process of appropriation and concentration of economic surplus, defined as the income accruing to property owners – capitalists. The core issue here is the allocation of that surplus and its impacts on growth.

The distributive conflicts behind the allocation of surplus in society are multidimensional processes in which political and institutional factors play a predominant role. These processes are always subjected to power relations – within capitalists and between capitalists and workers. The allocation of power underlying the formation of market power is rarely created within the strict functioning of the production sphere. It is more likely to be influenced by other phenomena: the existence of family networks, the structure of economic incentives created by the State and its institutions, or the type of ownership structures promoted by the banking sector.

Depending on its shape, these distributive conflicts can be associated to different economic outcomes. My argument is that the concentration and accumulation strategies of large capitalists, determined within the neoliberal institutional structure created in the 1980s/90s, were growth damaging. Hence the Veblenian term sabotage, to refer to the distortions associated to the process just mentioned: the prevalence of excess capacity, the maldistribution of profits, the bias towards speculative or non-productive activities, the channelling of State resources to inefficient sectors. These distortions are the root cause of indebtedness and weak investment and growth – stagnation.

Chapters 5 and 6 in part two provide the historical background to understand the accumulation and concentration strategies of the Portuguese capitalist class. The concentration of accumulated wealth and power is a long-term process that involves the configuration of legal rights, institutions, and socio-economic relations.

The purpose of chapter 5 is to identify the main actors and beneficiaries of those processes, to trace back the main elements that supported the accumulation regime during the fascist dictatorship. Chapter 6 explains the rupture in the previous accumulation system caused by the Carnation Revolution of 1974, and examines the foundations of the new neoliberal regime, consolidated in the 1980s and 1990s, as well as those of the newly formed capitalist class. It will be demonstrated that these elements are the background for the establishment of a system of profits without investment, which should be acknowledged in order to understand the Lost Decade.

Part three focuses on two different dimensions of the Lost Decade.

Chapter 8 provides an institutional analysis of the Lost Decade, illustrating how, through a set of neoliberal reforms in the context of the European integration, the State rehabilitated old fortunes and promoted new ones, which came to control strategic economic sectors – the banking system, privatised monopolies, construction. It argues that the strategies of these economic groups, based on rent-seeking behaviours and intra-class conflicts, were growth damaging. In this specific accumulation regime, profits accrued disproportionately towards the largest companies and oligopolies, which were not interested in productive forms of investment.

Chapter 9 complements the previous analysis by looking at the same historical period from a different angle. It shows that investment responds to the unequal distribution of profits and financial conditions within the non-financial sector. Behind stagnation and the

Portuguese slow economic recovery there is a systemic fragility: the mismatch between smaller enterprises, whose investment depends on their fragile financial conditions, and large groups, whose profits do not depend on investment, but on activities that accentuate their fragility.

Chapter 10 concludes, putting together the different elements in this dissertation to argue that stagnation in the Lost Decade was largely determined by the accumulation and concentration strategies of the Portuguese capitalist class in the context of a defective economic structure.

Finally, it should be noted that other distributional aspects, such as the role of capital-labour and wage inequalities are not considered in this dissertation, since its focus is the link between the Portuguese macroeconomic performance and the specific institutional aspects of the country's long-term processes of organisation of its capitalist formations.

Nonetheless, the proposed approach has the advantage of providing a concrete and endogenous argument of why investment has been dismal and economic recovery slow. This argument is grounded on solid institutional and historical foundations, avoiding relying on theoretical simplifications and abstractions – abundant in the Wickesellian and supply side theories – at the cost of several degrees of realism.

1.3. Contribution

The originality and contribution of this thesis lies in its multidisciplinary – economic, institutional and historical – approach to stagnation, translated, in the first place, in the combination of different fields of literature. Ground breaking debates in the history of economic thought are recovered to put forward a critical analysis of the mainstream theories of stagnation. In the same fashion, heterodox theories of stagnation are re-interpreted through the lenses of the classical institutionalism of Veblen and new approaches to rentism from development studies, to uncover the institutional nature of economic processes and dynamics.

A particular effort is made to explain the concrete elements behind the historical process of concentration of market power, commonly presented as a purely economic phenomenon, taking place within the production sphere. A rent-seeking approach is employed to frame the formation of specific structures of incentives that contribute to

explain the maldistribution of surplus in the root of under-investment theories of stagnation.

Furthermore, this dissertation tries to bring some clarity to the concept of capital. In economic theory, capital often appears has a factor of production, a stock of fixed assets. This misrepresentation of capital allows dubious interpretations of the meaning of concepts such as accumulation and concentration of capital. A broader definition of capital, in the light of Nitzan and Bichler's (2009) proposal based on Veblen's theory, allows a theoretical connection between the accumulation of capital and stagnation, through sabotage. These elements are the basis of the original framework proposed to analyse stagnation in Portugal.

This eclectic approach that crosses the frontiers of different disciplines is also methodological, through a combination of economic but also historical and institutional angles. Apart from *Donos de Portugal* (Costa et al., 2010), which is mostly an historical and political study of the capitalist class, the other accounts of the Portuguese economic structure, especially during the Lost Decade, are solely focused on the European integration or the financialisation process. This dissertation is the first attempt to explain the country's macroeconomic outcome – low investment and indebtedness in the Lost Decade – based on Kalecki and Steindl's theories of stagnation.

To fulfil this attempt, this dissertation relied on different type of sources, that include statistical data, but also historical monographies, newspapers, all sort of official and legislative documents and unexplored primary sources, in particular the reports on the banking system from the archives of the Ministry of Finance and the *Banco de Portugal*. Finally, the effort put in the reconstitution of the Portuguese mixed conglomerates could add an original contribution to the field of business history, still undeveloped as an autonomous discipline within the field of economics.

PART I: LITERATURE REVIEW AND THEORETICAL DISCUSSION

2. A critique to the mainstream debate on stagnation

2.1. Introduction

The growing awareness over the economic regularities identified in the previous section – low economic growth and investment rates, high indebtedness and financial asset valuation, slow post-crisis recovery – motivated an important debate in mainstream economics.

This chapter reviews and discusses the mainstream debate on stagnation, instigated by Larry Summers in 2013. Section 2.2 summarises the three types of approach to stagnation identified by Baldwin & Teulings (2014): i) a long-term downward shift in potential output; ii) a demand shortage or saving glut, related to the secular decline in the natural interest rate; iii) an external shock on potential output caused by the crisis.

Mainstream arguments are built upon two central concepts – the potential output and the natural interest rate. I argue that these abstract constructions can only exist within a neoclassical framework that has an implicit a view of the capitalist system structured in two realms: the real realm, where production takes place with labour, capital and technology generating the (potential) output; and a monetary realm, where the (natural) interest rate that governs demand is given by the saving-investment relation. According to this view, investment is what is left from consumption smoothing decisions – saving – and does not interfere with the long run structure of the supply side, the real side. Furthermore, on the production side, where wages and profits are generated, distribution depends on demand and supply of production factors (capital and labour).

There is, however, an alternative view of capitalism: a system in which production, distribution and, therefore, demand depend on political and institutional factors. The shape of institutions, choices of public policy, the opposing interests of different classes regarding their place in the production process determine the conditions of production and distribution. One institution, the financial system, has particular influence in that process. Not because it intermediates pre-existing resources, transforming saving into investment, but because it finances investment and determines the financial conditions of the corporate sector. In this system, money is not conceived as a *numeraire*, added to express real value embodied, for example, in the production factor capital. Money appears as social relation of debt and exists as value.

There are few debates where the opposing structures of these two visions have been more exposed than in the classical dichotomy and the capital controversies. The confronting arguments in these debates are reviewed in sections 2.3.1 and 2.3.2 to demonstrate that both the natural interest rate and potential output are far from consensual concepts outside neoclassical thinking.

Section 2.3.3 revisits mainstream theories in the light of these debates on economic theory. The different contributions are divided in two groups: Wicksellian theories, focussed on monetary aspects surrounding the natural interest rate and the capacity of monetary policy to achieve it; and supply side theories, related to finding the real aspects behind the downward tendencies affecting potential output.

Section 2.4 closes, arguing that, because these theories are ultimately grounded on flawed neoclassical theoretical foundations – wrong theory of money and capital –, their stagnation principle can only be exogenous or based on highly abstract concepts. Either way, both Wicksellian and supply side theories of stagnation ignore a crucial element in the organisation and functioning of capitalist economies: its political and institutional nature, determined by relations of power.

2.2. The mainstream debate

The current debate on secular stagnation was instigated by Lawrence Summers' speech at an IMF conference in honour of Stanley Fisher in 2013 (Summers, 2013).

The debate opened by Summers was summarised in an e-book organised by Baldwin & Teulings (2014). Despite the different approaches, they seem to have reached a consensus over three main aspects of stagnation. First, its definition: 'that negative real interest rates are needed to equate saving and investment with full employment' (p.2). Secondly, the main economic concern: 'the key worry is that secular stagnation makes it much harder to achieve full employment with zero lower bound (ZLB) on policy interest rates' (p.2). The third is the need for innovative monetary and fiscal instruments to deal with this situation.

A useful way to discuss mainstream thoughts on secular stagnation is to follow the structure proposed by Teulings and Baldwin's e-book, based around three approaches.

The first comprises the arguments connecting stagnation to a downward shift in potential output, motivated by a corresponding change in the growth of productive inputs, productivity, or both. Gordon (1990) suggests that the relative lower prices of investment goods makes the same level of investment less relevant in GDP. On the other hand, Hsieh & Klenow (2007) argue that countries where the domestic relative price of investment is higher will present lower investment rates and that differences in relative prices are not caused by higher investment costs but by low prices of consumption goods. Gordon (2012) questions if the high growth figures in the past were not the exception in human history. The main argument is that, while electricity or petroleum innovations have changed the entire production process, today's innovations have a much smaller range of application and are less likely to drastically change the way of living.³ Moreover, in the future, growth derived from these innovations will be held back by six 'headwinds': decline in demographic expansion; rising inequality; education; environmental regulations; globalisation (leading to factor price equalisation) and debt overhang. The result will be low output growth and even lower consumption growth rates. A similar argument is developed by Kasparov and Thiel, in an article published in Financial Times: 'On the campuses of Google and Apple, high-design bathrooms or espresso bars might look very different from the average non-tech company, but their balance sheets show the same vast piles of idle cash you'll find at Pfizer or Chevron. If we were living in an era of accelerating technological progress, Apple could reinvest its returns in new projects instead of fighting patent battles over old ones while moonlighting as the world's biggest hedge fund' (Kasparov & Thiel, 2012).

Glaeser (2014) and Mokyr (2014) challenge Gordon's views. The former argues that there is no decline in US investment and innovation and that the jobless recovery is likely to be linked to non-macroeconomic factors, such as lack of qualifications or the excessive generosity of the American safety net. The latter recalls the unavoidable consequences of creative destruction and questions the capacity of the current statistical apparatus to fully reflect the macroeconomic impact of technological innovations.⁴ Glaeser (2014) adds that, despite the importance of new advances in technology, new inventions are more focused on specific groups and less capable of affecting the masses (it is therefore a problem of 'range of applicability', as mentioned by Eichengreen). Eichengreen (2015b)

³ According to Gordon (2012) the First Industrial Revolution occurred in steam and railroads from 1750 to 1830; the Second in electricity, internal combustion engine, running water, indoor toilets, communications, entertainment, chemicals and petroleum, from 1870 to 1900; and the Third in computers, the web, mobile phones from 1960 to present.

⁴ Mokyr (2013) and Brynjolfsson & McAfee (2011) also argue that the fundamentals for innovation are strong.

also opts for a more ‘optimistic view’, admitting ‘what we are experiencing at the moment is not secular stagnation but a fit of impatience. It is not unprecedented for three decades of incremental innovation, standardization and adaptation to have to pass before the efficiency advantages of radical new network technologies begin to show up in TFP statistics. Thus, that the IT revolution, as captured by TFP growth, took a decade-long pause between 2005 and 2015 may be less a portent of secular stagnation than a harbinger of better times to come.’ (pp.9-10)

Another strand of the supply-side view brings back Schumpeter’s idea that it is the anti-business climate, caused by wrong policies, that discourages investment. Taylor, J.B. (2014) claims that excess regulation and uncertainty have a detrimental effect on investment and growth. Baker, Bloom, & Davis (2013) developed the hypothesis that economic crises are followed by periods of political instability that hamper investment. De Bondt, Maddaloni, Peydró, & Scopel (2010) argue that excessive requirements in banking regulation and capital ratios created difficulties in terms of credit rollover and growth recovery.

The second approach concerns the standard Keynesian idea that aggregate demand shortages can inhibit the economy from reaching its potential. Both Summers and Krugman stress the point that with policy interest rates reaching zero, there is little room for improvements regarding employment and economic growth.

Krugman (2014) summarises his approach in four observations. The first is that, as mentioned above, a zero lower bound is a prolonged and serious problem in the sense ‘that the liquidity trap is becoming the new normal’ (p. 62). The second observation adds that the decline in real interest rates has been going on since the beginning of the Great Moderation. Thirdly, the conditions that allowed for an increased level of spending in the 2000s (high indebtedness levels) are not likely to play the same role in the future. The result will be a great downward pressure on the natural rate of interest. Based on these three assumptions, Krugman suggests that the liquidity trap might not be a temporary phenomenon posing new challenges to both fiscal and monetary policy. Monetary policy will face difficulties getting traction in a situation of low demand and fiscal policy cannot work as a permanent bridge to compensate for the missing demand. Krugman argues that Summers’ argument is compatible with his theory of a ‘permanent liquidity trap’.

In short, different factors have affected people’s expectations about their future income and led them to save more in relation to investment, causing the natural rate of interest to

fall below zero. The only way to decline the real interest rate sufficiently is to increase inflation by making people believe that the hike in money made available by the ECB is permanent. In Krugman's words, 'one way to get there would be to reconstruct our whole monetary system – say, eliminate paper money and pay negative interest rates on deposits. Another way would be to take advantage of the next boom – whether it's a bubble or driven by expansionary fiscal policy – to push inflation substantially higher and keep it there. Or maybe, possibly, we could go the Krugman 1998/Abe 2013 route of pushing up inflation through the sheer power of self-fulfilling expectations' (Krugman 2013). Later Krugman (2015) recognised the limitations of monetary policy and the need for fiscal mechanisms to take on a stronger role in fighting stagnation.

Summers (2015) makes clear his disagreement with the liquidity trap argument, mostly because it assumes that, by the works of some *deus ex machina*, the economy can be lifted from the trap as real interest rates go down. However, '[t]he essence of the secular stagnation and hysteresis ideas that I have been pushing is that there is no assurance that capitalist economies, when plunged into downturn, will over any interval revert to what had been normal'. DeLong & Summers (2012) argue that in the present context 'there are "hysteresis" effects: a depressed economy is one in which investment is low; in which the capital stock is growing slowly; and in which workers without employment are seeing their skills, their weak-tie networks they use to match themselves with vacancies in the labor market, and their morale decay. All of these reduce potential output. In future periods production is supply determined, and equal to potential output.' (p. 6) So, in this case, a slow aggregate demand will lead to a fall in the long-run supply.

As for the factors that led to such situation, Summers' approach is similar to Krugman's argument: a collapse in demand caused by several shocks that led to an increase in saving rates and a decrease in investment. Under normal circumstances, interest rates would go down to equilibrate both sides; however, when the zero lower bound is reached, the disequilibrium becomes permanent. Furthermore, if any attempts to bring about further declines in the real interest rate will probably feed up new financial bubbles (Summers, 2014). The opposite strategy is to raise the natural interest rate by investing in infrastructures, boosting spending power and redistributing income.

In these theories, interest rates play a crucial role in explaining the persistence of output gaps in mature economies and, therefore, stagnation. Several authors – such as Krugman or Blanchard — draw attention to the downward trend in real interest rates observed in

the US and the Eurozone. Like Summers, they argue that such a decline will require negative real rates to bring back an equilibrium between saving and investment, a hard task for monetary policy in times of low inflation.

Blanchard, Furceri, & Pescatori (2014) identify three downward pressures on equilibrium real interest rates, namely: i) the savings-supply schedule, ii) the investment-demand schedule, and iii) the relative demand for safe versus riskier assets (p. 103). They conclude that – despite the counteracting effect of higher education levels – an increase in life expectancy, lower retirement age and a decline in the population’s growth rate have escalated the stock of savings and, therefore, the supply of loanable funds, pushing the savings-supply schedule outwards. Blanchard resuscitates Bernanke and Greenspan’s *savings-glut* theory to make a connection between saving in emerging economies and lower real interest rates in the US.⁵ On the demand for loanable funds side, Glaeser (2014) mentions how high value-added inventions may affect the investment-demand schedules, since their market value is completely dissociated from the capital committed to it (the case of software apps). Caballero & Farhi (2014) attribute the falling interest rates to the joined effect of a lower supply of safe financial assets and an increased demand for it due to new regulation requirements.⁶ For Blanchard et al. (2014), this increased demand for safer assets reflects the surge in private savings, as well as countries’ foreign reserves policies.

Finally, authors in the third approach, like Glaeser or even Summers, argue that events of crisis can inflict permanent damage on potential output, particularly through employment levels. It is ‘a sort of one-off supply-side damage’ preventing elements of potential output to go back to pre-crisis levels (Teulings and Baldwin, 2014, p.7). One example is the labour market, which is less able to recover from previous periods of crisis.

2.3. A critique to the mainstream debate

2.3.1. Theories of money and the classical dichotomy

According to Schumpeter, ‘there are only two theories of money that deserve the name ... the commodity theory and the claim theory, from their very nature, they are incompatible’ (Schumpeter, 1917/1956, p.649). A third view, monetary theories of credit,

⁵ Blanchard et al. (2014) find no link between investment and the decline in the natural interest rate in the pre-crisis period.

⁶ Gorton, Lewellen, & Metrick (2012) argue that there is no shortage of safe assets. Eichengreen (2015b) also defends that it is not likely that the decline in interest rates is connected to any short-term phenomena in financial markets.

appears also in Schumpeter (1954, p.717) as a related but weaker form of commodity money, also known as the loanable funds theory, or the neoclassic interest rate theory.

For classical economists — Ricardo, Smith, Marx and Mill — money was a commodity that reflected rather than determined real value. The latter was established in the production sphere. Money was a symbol of value, and a mechanism to ensure more efficient economic transactions. Therefore, commodities with the most convenient proprieties (durability, divisibility, portability and homogeneity)⁷ emerged as the common medium of exchange. As stated by Mill:

‘There cannot, in short, be intrinsically a more insignificant thing, in the economy of society, than money; (...) It is machine for doing quickly and commodiously what would be done, though less quickly and commodiously, without it.’ (Mill, 1848/1909, p.341)

This denial of money’s capacity to interfere with the ‘locus of value’, placed within the production sphere, is a key characteristic of classical economic monetary thought (Ingham, 2004). Whether that locus, or natural value, is found in labour, as in Marx⁸ or Ricardo, or in the ‘general conditions of supply and demand for labour, stock and land’ (Dobb, 1973, p.44) as in Adam Smith, the classical dichotomy applies. Hence, classical economic thought conceptualised two different realms: that of the real, where production and consumption take place and employment and output are determined; and the realm of the monetary or nominal, where the real value of real variables is reflected in money-values. Money itself is treated as another commodity, chosen to serve as medium of exchange, whose value derives, as with other commodities, from its production costs. Nominal and real realms are independent territories, in the sense that monetary values cannot affect real production, but only mirror it.

By the end of the Nineteenth Century, classic theories of value based on distribution and production were replaced by theories focused on the exchange process. This important twist drew attention away from conditions of commodity production and supply (money included), focussing instead on individual consumption, associated with satisfaction of needs. The neoclassical marginal revolution evaded the controversy over the objective

⁷ See Clower (1984).

⁸ ‘As value is but the embodiment of socially necessary labour, commodities exchange with each other in proportion to the labour quanta they contain. This is true for the exchange of iron against wheat, as it is true for the exchange of iron against gold or silver. Marx’s theory of money is therefore in the first place a *commodity theory of money*. A given commodity can play the role of universal medium of exchange, as well as fulfil all the other functions of money, precisely because it is a commodity, i.e. because it is itself the product of socially necessary labour. This applies to the precious metals in the same way it applies to all the various commodities which, throughout history, have played the role of Money’ (Mandel, 1990).

(or natural) value of goods by reversing the terms of the problem: commodities are valued at the price buyers are willing to pay for an additional unit, given the scarcity of that good.⁹ In the new subjective theory of value proposed by Jevons, Menger and Walras, the exchange value, or market price, is determined by subjective evaluation of an utility in relation to supply.

Theoretically, questions on the nature and value of money became subordinated to the impact of demand at any time. Analytically, the neoclassic general equilibrium models that followed were not capable of solving the internal logical inconsistencies related to the natural appearance of money. The Walrasian analytical device to achieve a state of market equilibrium in which prices are determined consisted of introducing an arbitrarily assigned *numéraire*, a symbolic representation of existing values in the economy. Walras also provided no explanation for how money gets into the system.

In this case, the introduction of monetary prices in the model is merely fictitious, since ‘all monetary transactions are *de facto* of the same nature as a barter exchange with a *numéraire* money having been introduced to it. They are simply exchanges of commodities of equal pre-existing value with *numéraire money* having a specific intrinsic value like any other commodity.’ (Parguez & Seccareccia, 2000, p.113)

The impacts of variations in the demand for money, which came to be the main cause of concern for late Nineteenth Century economists, were formally translated into the quantity theory. (Fisher, 1914/1911), based on the ideas of Hume, put forward a modern version of the Cambridge equation of exchange:

$$MV + M^1V^1 = \Sigma pQ = PT \quad (1)$$

As shown above, Fisher’s model added bank deposits (M^1) to cash balances (M) as part of the money supply, assuming this tend to be a constant ratio of the total money in circulation. The equation was mostly used to demonstrate the existence of a unidirectional and univocal relation that ran from the quantity (M^i) and velocity of money (V^i) to the general price level (P) times the amount of transactions in the economy (T). As in previous cases, the quantity theory could not provide a consistent explanation for how bank deposits appear, nor account for their relation to credit. In fact, ‘despite the inexorable growth of bank credit-money, orthodox academic economists clung, with

⁹ Without much time to explore the historical ascendants of the *subjective* or *utility* theory of prices, it is worth mentioning that the core idea of the relation between value and utility (or satisfaction) was already present in the work of Galiani or Jan Baptiste Say, although without the concept or marginal utility.

increasing desperation, to the anachronistic theory. Their model of money supply was, in effect, an empirical generalization of a naturally constrained supply of a metallic monetary base provided by a central authority (the mint) that was outside the market. That is to say, in the terminology of the late twentieth century, it was exogenous.’ (Ingham, 2004, p.22)

Notwithstanding its radical cut with previous value theories, the neoclassical model kept the essential elements inherited from classic monetary thought: a commodity money view and the classical dichotomy. The economy is divided into a real and a monetary sector; in the real sector, relative prices are determined in the fashion of the Walrasian general equilibrium models. Money enters this model as the lubricant that allows supply and demand to determine the relative market-clearing prices. The real sector determines the quantity of goods produced and their relative prices. The monetary sector, on the other hand, can only affect the absolute price level in the economy, given by the quantity theory of money.

Essentially, monetarist ideas from the 1970s were based on the restatement of Fisher’s quantity theory, albeit with some variations. The core argument put forward in *A Monetary History of the United States* (Friedman & Schwartz, 1963) is that, in the short run, the supply of money is able to influence economic activity and, mostly, the level of prices. However, at long term, real variables lean to their natural equilibrium levels, as the effects of the money illusion fade away. Therefore, in the long run, the prevailing rate of interest is the natural or real interest rate, which reflects the equilibrium of supply and demand in real capital markets and cannot be influenced by the short-term money interest rate, determined in the market for loanable funds. Also, in the present moment, differences between both rates will trigger cumulative processes of over or under heating of the economy.¹⁰ Following the same rationale, it is accepted that there is only one natural rate of employment (NAIRU), which will not lead to inflationary pressures.

Monetarism was defeated by the empirical evidence that the money supply is extremely difficult to measure and hardly controllable. By the beginning of the Nineteenth Century, credit money theorists challenged Fisher’s quantity theory, arguing that money can be created endogenously by the issuance of claims backed by debt.

¹⁰ The main framework behind Friedman’s explanation of economic fluctuations is based on Wicksell’s cumulative process, which will be subject of further analysis somewhere else in this paper.

The monetarist consensus was abandoned and gave rise to a new benchmark, proclaimed by Goodfriend & King (1997) and largely developed by Woodford (2003) under the label of new neoclassical synthesis (NNS). The Wicksellian natural rate of interest theory was introduced in order to include money endogeneity in the foundations of the new consensus and reject the fundamentals of the quantity theory. Ironically,

‘Wicksell regarded it as the only solid foundation for monetary theory and saw his own contribution as a development of the Quantity Theory. With Quantity Theory, however, he understood simply the equilibrium proposition that prices will be proportional to the money stock in the long run and not the modern monetarist proposition that exogenous changes in base money drive nominal income and prices.’ (Leijonhufvud, 1979, p.24)

The Wicksellian inspired NNS theories will be looked at in detail next. However, as argued by (Fontana, 2007), ‘in this regard, the main tenet of this alternative Wicksellian view of monetary policy is that despite all theoretical and empirical progress, the new consensus view endorses a modified version of the old neoclassical dichotomy between the monetary and real sectors’ (p. 52). The acceptance of Keynesian propositions that wage and prices suffer from nominal rigidities led to the necessarily conclusion that, in the short run, the interest rate set by the central bank is able to affect the market rate and, by doing so, the real variables in the economy. In the long run, there is no place for nominal rigidities and, therefore, no place for money to influence the course of economic events. In the end, money does not matter. The new consensus rejection of short run money neutrality is a matter of pragmatism, not a theoretical feature of its framework.

Credit theories of money, as opposed to the Aristotelian commodity view, have existed since the Fifteenth Century. They fell under the scope of study of philosophers, sociologists and historians until, as a consequence of the methodological dispute (*Methodenstreit*) in the beginning of the Twentieth Century, the subject was ‘gained’ to the economics ‘side’ (Schumpeter, 1954).

Within the economics side, few were capable of putting forward a coherent alternative to the quantity theory of money. As stated by Wicksell:

‘It is far easier to criticize the Quantity Theory than to replace it by a better and more correct one. Up to the present every attempt in this direction has come to grief; or rather, scarcely a single serious attempt has been made, apart from the Cost of Production Theory, which to-day, except in orthodox Marxist circles, can no longer reckon on any direct supporters.’ (1898/1936, p.43)

Besides Wicksell's pure credit economy contribution, integrated theories of money appeared only in beginning of the Twentieth Century, in the works of Keynes (1930/2015), Schumpeter (1954, 1934/1983) Kalecki and others. There is still no unified consensual credit money theory. Nevertheless, most credit theorists would agree with the following premises: i) money is not a neutral variable in the economic system, a mere *veil*. On the contrary, '(...) it has to be recognized that essential features of the capitalist process may depend upon the "veil" and that the face behind it is incomplete without it' (Schumpeter, 1954, p.278); ii) money is a claim, a promise to pay, whose value and quantity do not depend on the quantity/price of precious metals or their modern version – high powered money in the form of legal tender; iii) money is an endogenous variable.¹¹

One can now return to Schumpeter's classification of money theories. In short, the commodity view sees money as a medium of exchange incapable of generating other disturbances in the 'real' economy apart from inflation. Money cannot be created *ex-nihilo*, and, therefore, investment depends on previous saving. Monetary theories of credit involve the neoclassic interest rate theories. In these theories, bank credit is admitted, as well as liquidity preferences and hoarding. The interest rate results from the intersection between the supply and demand of loanable funds which are, in turn, determined by saving and investment decisions. Credit theories of money, on the other hand, treat money as an endogenous variable, a symbol of embedded social relations of debt.

Schumpeter argues that 'it is by no means clear that the most useful method is to start from the coin – (...) - in order to proceed to the credit transactions of reality. It may be more useful to start from these in the first place, to look upon capitalist finance as a clearing system that cancels claims and debts and carries forward the difference – so that 'money' payments come in only as a special case without any particularly fundamental importance. In other words, practically and analytically, a credit theory of money is possibly preferable to a monetary theory of credit.' (1954, p.717)

In this latter case, money is not neutral in the economic process and its value does not derive from the quantity of precious metal or hard money issued by any central bank. This conception of money as social relation allows power to enter the picture, as one of the main elements that allows accumulation and social reproduction. It is, therefore, the

¹¹ This is not to say that there are no other limits to money supply. This idea is the focus of the debate between *structuralism* and *horizontalism* in the post Keynesian theory.

appropriate theory to support the present analysis of stagnation as a structural and endogenous outcome of capitalism, and not merely as a monetary phenomenon.

2.3.2. Theories of capital and the Cambridge Controversies

In the first sentence of ‘What is Capital?’, Fisher admitted that ‘of economic conceptions few are more fundamental and none more obscure than capital.’ (Fisher, 1896, p.1)

According to Schumpeter, the concept of capital as income or financial flows predates that of capital as a means of production:

‘[T]he concept was essentially monetary, meaning either actual money, or claims to money, or some goods evaluated in money ... What a mass of confused, futile, and downright silly controversies it would have saved us, if economists had had the sense to stick to those monetary and accounting meanings of the term instead of trying to “deepen” them!’ (Schumpeter, 1954, p.306)

The origins of the theory of capital that operated this transformation are credited to Quesnay and the physiocrats. The foundational idea, present in the *Tableau économique*, is that production requires advances of goods, which can be expressed in money form (capital). Turgot ‘emphasized – one may almost say, he “rubbed in” – that wealth other than natural agents (*richesse mobilière amassée d’avance*) is a *préalable indispensable* for all production (*Réflexions*, LIII), which amounts to offering his shoulders for future attempts to treat capital in this sense as a factor of production’ (p. 307). Adam Smith also departed from Quesnay’s suggestion, but, rather than an interest rate theory of capital, he developed the concepts of fixed capital (primitive advances) and circulating capital (annual advances). The focus was not, as it would later be pointed by Fisher, on the distinction between stocks and flows, but between those commodities constituting capital and income.

While tracing the origins of the non-monetary interpretation of capital, Schumpeter also refers to the corresponding theory of saving and investment, developed by Smith and Turgot. Smith’s moralist theory of investment, based on parsimony, and not on industry, created the basis for the interpretation – still prevailing – that saving generates a corresponding investment, ‘or that, to put differently, saving practically amounts to supplying (real) capital’ (p. 309).

John Bates Clark distinguished between true or permanent capital and capital goods.

Clark started by claiming that '[c]apital consists of instruments of production, and these are always concrete and material... the capital of the world is, as it were, one great tool in the hand of working humanity ...' (1899/1908, pp.116-117). The distinction between capital and capital goods is a matter of aggregation and abstraction, or permanence, in the words of Clark. The main idea is that capital goods must be destroyed for the production process to happen, so that true capital can last and increase. The concrete instruments necessary for production – capital goods – earn a rent, associated to their production capacity. On the other hand, the capital embodied in all production goods yields an interest rate. The following example clarifies the difference:

'Make an inventory of all the concrete instruments of production that the world contains, including in the list every commodity that helps to produce other commodities and putting opposite the name of each article the sum that in a year it can earn for its owner. Add together all these sums, and the gross amount is the total income of the property-holding class, as this income is reduced to the form of rent. Now take a different course. Make the same inventory of capital-goods as before, appending to the name of each article the value that it embodies. Add together these values, and the grand total will describe the permanent capital of the world. Find what part of itself this fund will earn in a year, and you have the *rate* of interest.' (p.124)

Based on this, Clark clarifies Stuart Mill's, as well as Smith and Turgot's, proposition that capital results from abstinence. This is only true for permanent capital. The mere creation of capital goods to replace the existing stock can be funded by the income of previous production. Replacement capital, as wages, will be funded with the continuous outcome of their relative and incremental contributions to production or, in other words, by their marginal productivities (Clark, 1899/1908). Nevertheless, whether in its individual instrumental form (capital good) or in its abstract and permanent form, (capital) both concepts are always referred to as material realities.

Veblen's critiques of Clark's and Fisher's capital theory represent the first round of the capital controversies in economic theory (Cohen, 2014). The attack on Clark's theory was twofold. On the one hand, it targeted the nature and measurement of capital and, on the other, the adequacy of the marginalist equilibrium analysis, as opposed to an evolutionary approach. In short, Veblen saw capital not as a stock of goods, but as a social and political entity.

Veblen questions Clark's positivist method and his conception of capital and points out the main contradictions in the marginalist theory. As an example, according to Veblen,

Clark's theory stands on two contradictory views on capital (Veblen, 1908c, p.163; see also 1905). On the one hand, capital is presented as a material entity, a stock of physical goods; on the other, capital appears as homogenous abiding entity, whose characteristics of mobility and fluidity are not compatible with its original material nature.

If capital is not a material or physical entity, 'it should be extremely difficult to determine what share of the value of the joint product of capital and labour should, under a rule of "natural" equity, go to the capitalist as an equitable return for his monopolization of a given portion of the intangible assets of the community at large.' (Veblen, 1908c, p.167)

According to Veblen, Clark's failed attempt to deal with the immaterial nature of capital, by creating two separate entities – capital and capital-goods –, coincides with Fisher's distinction between capital and capital-value.

Differently from earlier approaches, Fisher (1899/1908) focused on the classification of wealth between capital and non-capital goods. Fisher argued that the crucial distinction is not between types of goods, but rather between different appearances of wealth, depending on time. Capital is a stock of wealth, whereas income, necessary for production and consumption, is a flow of wealth.

'The total capital in a community at any particular instant consists of all commodities of whatever sort and condition in existence in that community at that instant, and is antithetical to the streams of production, consumption and exchange of *these very same commodities*.' (p.514)

The important distinction, however, is not between stock and flow, but between stock and the rate of flow (which gives a measure of income per unit of time). This distinction 'brings Capital into the simplest and most intimate relation to Interest. When a stock of goods or capital is exchanged for a perpetual flow of goods or income, the ratio of exchange constitutes the *rate of interest*' (p.515). In this sense, Fisher defends that the interest is the value of money in the sense that capital is not lent at interest but sold for interest. Interest is the purchasing power of capital.

Fisher's theory was developed in *The Nature of Capital and Income* (1906), and *The Rate of Interest* (1907), both reviewed by Veblen (1908b, 1909). The key idea is that the present stock of capital (capital-wealth) produces future consumption services that yield an income, discounted to the present at the rate of interest. The income discounted is what gives the present stock of capital its value (capital-value). The rate of interest is determined by subjective considerations on impatience and objective investment

opportunities.

The pecuniary nature of capital-value is, according to Veblen, an improvement, but also a contradiction towards Fisher's hedonistic approach, manifest in the concept of income-services as physical income (Cohen, 2014, p.1501). As a matter of fact, notwithstanding its pecuniary appearance, in Fisher's approach, income and, therefore, capital value, are a flow of physical services equivalent to a stock of capital goods, valued by the utilitarian balance between impatience and opportunity. In other words, in Fisher's theory, that which gets capitalised by the discount rate is the utility of physical capital goods.

The questions raised by the first capital controversies were revisited twice: first between Kaldor, Hayek and Frank Knight, in the 1930s and, after that, by Joan Robinson and her colleagues, against Samuelson, from mid 1950s to mid 1970s, during the Cambridge controversies.

In "Thinking about Thinking", Robinson described how, while under criticism for her questions on the nature and quantity of capital – 'everyone except Joan Robinson knows perfectly well what capital means' – she realised Veblen had made the same point in 1908, 'much better than I did' (Robinson, 1970, p.116). The specific paragraphs quoted in Robinson contain two main ideas: the dual nature of capital, as a fund of financial value and a pool of industrial goods, and the political nature of the process of capital accumulation.¹²

Robinson (1953) was concerned with three aspects of the existing capital theory: i) the nature of capital; ii) its measurement; and iii) how could the economy be conceived at equilibrium.

The dual nature of capital can be reconciled if one thinks of capital as *value*, which can change throughout time:

'Capital when it consists of as yet uninvested finance is a sum of money, and the net receipts of a business are sums of money, But the two can never coexist in time. While the capital is a sum of money, the profits are not yet being earned. When the profits (quasi-rents) are being earned, the capital has ceased to be money and became a plant.' (Robinson, 1953, p.84)

Robinson argued that in equilibrium different methods of measuring capital (cost of

¹² 'Much is made of the doctrine that the two facts of 'capital' and 'capital goods' are conceptually distinct, though substantially identical. The two terms cover virtually the same facts as would be covered by the terms 'pecuniary capital' [finance] and 'instrumental equipment' (...). the continuum in which the 'abiding entity' of capital resides is a continuity of ownership, not a physical fact. The continuity, in fact, is of an immaterial nature, a matter of legal rights, of contract, of purchase and sale. Just why this patent of the case is overlooked, as it somewhat elaborately is, is not easily seen.' (Veblen in Robinson, 1970, p.116)

production, future earnings or productivity) yield equivalent results. However, in the event of a crisis, the past cost will no longer be equivalent to the present perceived value. It will be impossible to identify the *real* quantity of capital.

‘All these puzzles arise because there is a gap in time between investing money capital and receiving money profits, and in that gap events may occur which alter the value of money.’ (p. 84)

Furthermore,

‘The heavy weight which this method of valuing capital puts upon the assumptions of equilibrium emphasises the impossibility of valuing capital in an uncertain world. In a world where unexpected events occur which alter values, the points of view of the man of deeds, making investment decisions about the future, and of the man of words making observations about the past, are irreconcilable, and all we can do is botch up some conventional method of measuring capital that will satisfy neither of them.’ (p. 90)

None of the proposed neoclassical methods managed to evade the circular reasoning concerning quantity of capital and the rate of interest. In both – discounted future earnings or the money cost of past capital goods – the interest rate was needed to calculate the quantity of capital. It was, therefore, impossible to conceive and derive the rate of interest as the return on that same quantity of capital. Even in equilibrium, there is no abstract unit to measure the quantity of capital independently from the distribution process (the determination of prices, interest rates, profits and wages).

Criticism of the mainstream production function and mainstream thinking of capital as a physical entity are recurring themes in Robinson’s contributions. In “The Meaning of Capital” (Robinson, 1977/1979), capital is again presented as value, embodied in different forms of productive capacity:

‘The concept of “capital” as something distinct from physical means of production is connected with business experience. A new business sets out with a sum of money, whether owned by the proprietors or borrowed at interest. The money is invested in means of production and work in progress. So long as the business is successful, the value of the original investment is kept intact. It may be augmented by further investment financed out of profits or by further borrowing. A part of gross profit is treated as an amortisation fund. With the passage of time, the original form of the investment may cease to be the most profitable and the first stock of means of production is replaced by another, embodying a different technique or aimed at a different market. Thus the initial finance (so long as the business is successful) continues to exist as a sum of value being continuously embodied in different forms of

productive capacity. But finance arises out of relationships within an economy.’ (p. 61)

Besides Robinson’s contribution, the debate over the correct measurement of capital and its implications on the distribution process featured, on the British Cambridge side, the contributions of Champernowne (1953) and, most notably, Sraffa (1960/1975), who opened the famous debate on double-switching and capital reversing. Some argued it destroyed the foundations of the neoclassical theories of distribution.

Harcourt (1969, 1972) and Cohen & Harcourt (2003) provide a detailed description of all stages in the Cambridge controversies and the attacks on neoclassical marginal productivity theories of distribution. These debates occurred simultaneously with the development of alternative theories of distribution and accumulation. The theoretical common core of such approaches is the idea that distribution is not the product of pricing. In order to go from potential to effective, the rate of profit must be realised. That realisation depends on the effective demand associated with different saving and spending patterns of each class. It is, intrinsically, an institutional and political problem.

2.3.3. The mainstream debate revisited

The role of the previous section was twofold: on the one side, to present the main theories of stagnation currently in debate, identifying their main hypothesis and arguments; on the other, to discuss the relevance and validity of the theoretical premises supporting these theories. Table 1 summarises the framework for this analytical approach.

The different theories of stagnation identified – Wicksellian and supply side – are organised according to the stagnation principle – the causing factor — proposed, presented through the identification of its key variables and key arguments. These theories are also analysed in four related dimensions, discussed in the previous sections: the underlying theory of money, as identified by Schumpeter, which is associated to the role played by the financial sector; the underlying theory of capital, as discussed in the capital controversies; and the endogenous or exogenous nature of the stagnation principle. The endogeneity of each theory derives naturally from its view of money and capital as condensations of political and social relations.

This analysis framework exposes the neoclassical foundations of current theories of stagnation, which are mostly based on non-credit money views and marginalist-inspired

production functions. The implications of such theoretical choices will be discussed in the next sections

Table 1 - Current Stagnation Theories

Theories of Stagnation	Stagnation Principle	Key Variables	Key arguments	Authors	Role of the financial sector	Theory of Money	Theory of Capital	Nature
Supply side	Decline in the price of investment goods	Prices Total Factor Productivity	Innovations lower the relative price of investment goods.	Gordon (1990)	None	n.a.	Production Factor	Exogenous
	Technological innovation	Total Factor Productivity	Changes in technological patterns due to the limited impact of innovations coming from the third industrial revolution on methods of production and living standards.	Gordon (2012), Kasparov & Thiel (2012), Eichengreen (2015b), Gleaser (2014)	None	n.a.	Production Factor	Exogenous
	Anti-business climate	Regulation Public intervention	State intervention, political uncertainty, capital and financial market regulations stop economic recovery.	Baker et al. (2013), De Bond et al. (2010), Taylor (2014)	Intermediator	Commodity money	Production Factor	Exogenous
Wicksellian	Zero bound	Investment Saving Real interest rate	Decline in interest rates due to a shortage of financial assets.	Caballero et al. (2016)	Intermediator	Monetary theory of credit	Production Factor	Endogenous

			<p>Higher saving/low investment propensity due to:</p> <ul style="list-style-type: none"> i. Global savings glut ii. Inequality iii. Exogenous shocks: population ageing, demographic decline iv. Expectations of income decline v. Inadequate fiscal policy 	<p>Bernanke (2015), Summers (2014), DeLong & Summers (2014), Krugman (2014)</p>	<p>Intermediator</p>	<p>Monetary theory of credit</p>	<p>Production Factor</p>	<p>Endogenous</p>
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2.3.3.1. Wicksellian theories

The foundations of the Wicksellian theories of stagnation can be found in the new neoclassical synthesis (NNS), or new macroeconomic consensus (NCM), which provided a bridge between neoclassical and new Keynesian economics. Its main contributor was Michael Woodford. In *Interest and Prices* (2003), Woodford proposed a neo-Wicksellian framework, composed by a three-equation model: an aggregated demand (AD) equation, similar to the traditional IS curve, relating the output gap to the interest rate (2); a new Keynesian Phillips curve, describing the relation between inflation and the output gap (3); and a monetary policy strategy function, similar to the Taylor rule, in which the difference between the market and the natural rate varies with the gap between current and target inflation rates (4). Woodford (2003) resuscitates Wicksell's cumulative process, to put forward a theory of inflation targeting based on the analysis of interest rate and output gaps. At its core, there is the idea that, as long as the Central Bank can close the inflation gap, economic activity will be stable and close to its potential. In order to represent that notion, he suggests the following equation:

$$Y - Y^* = a_1(Y_{t-1} - Y^*_{t-1}) + a_2 E_t(Y_{t+1} - Y^*_{t+1}) - a_3 [R_t - E(P_{t+1})] + X_t \quad (2)$$

From equation 2 we get that the output gap — the difference between actual (Y) and trend or potential (Y^*) output — depends on the past output gap ($Y_{t-1} - Y^*_{t-1}$), on the expectations regarding future gaps ($E_t(Y_{t+1} - Y^*_{t+1})$) and, negatively, on the real interest rate ($R_t - E(P_{t+1})$). It is an exercise of intertemporal optimisation of expected lifetime utility, in which decisions regarding present and future consumption are made according to a discount rate (gross rate of interest) and subject to a budget restriction.

To make the optimisation tractable, most models assume that agents will not default on their debts [the transversality condition]:

‘this makes *all* agents perfectly credit worthy. Over any horizon there is only one interest facing *all* agents, i.e. no risk premia. All transactions can be undertaken in capital markets; there is no role for banks. Since all IOUs are perfectly creditworthy, there is no need for money. There are no credit constraints (...). Money is generally introduced into the model by auxiliary *ad hoc* frictions, e.g. cash in advance requirements or limited participations, both of which are totally internally inconsistent with a world without any default. Essentially, therefore, the consensus three-equation model assumes a non-monetary, non-banking system, so it is no surprise that most theoretical adherents of it tend to downplay attention to, or concern with, purely monetary variables.’ (Goodhart, 2008, p.826)

Toporowski (2012) argues that the super endogeneity condition introduced in the new consensus had the effect of nullifying some of the aspects that should arise naturally with the introduction of the endogenous money hypothesis:

‘In the recent work of Michael Woodford, a “pure credit” economy has come to mean one in which the money supply is strictly endogenous, to the point where illiquidity is impossible (because additional credit can, by assumption, always be obtained). However, Wicksell’s “pure credit” economy is one in which credit serves as a means of payment, and credit is unconstrained by bank reserves. *This is a much better description of twenty-first century banking in the financially advanced countries, than that of Woodford, if only because it does not exclude all those issues of insolvency and illiquidity that have come to trouble us today* [emphasis added].’ (p.4)

So, the new monetary consensus is, in fact, a non-monetary theory. As argued above, nominal rigidities that affect real variables in the short run disappear in the long run, so money neutrality remains a key characteristic of the NMC theoretical framework.

One last aspect concerning the aggregate demand function is the obvious absence of an investment function explaining firms’ investment decisions. In the NMC, investment is required to increase the capital stock according to the predetermined path of the economy. In the equation, this is based on consumption smoothing decisions.

We can now move to the Keynesian Phillips Curve:

$$P_t = b_1 (Y - Y^*) + b_2 P_{t-1} + b_3 E_t(P_{t+1}) + Z, \quad b_2 + b_3 = 1 \quad (3)$$

The equation relates inflation (P_t) to the output gap ($Y - Y^*$). Past levels of inflation (P_{t-1}) reflect the stickiness of prices in the short term, while expected future inflation ($E_t(P_{t+1})$), assuming rational expectations, captures the credibility of the Central Bank to influence today’s inflation by lowering tomorrow’s expected increase in prices (without compromising output growth). The sum of the coefficients b_1 and b_2 should be 1, in order to represent the vertical Phillips Curve. In the long run, the output gap is closed and unemployment rests at its natural rate, regardless of prices.

Finally, the policy function that completes the system is:

$$R_t = R^* + E(P_{t+1}) + c_1 (Y_{t-1} - Y^*_{t-1}) + c_2 (P_{t-1} - P^T) \quad (4)$$

The nominal interest rate (R_t) is defined according to the equilibrium (or natural) interest rate (R^*), the expected price inflation ($E(P_{t+1})$), the output gap ($Y_{t-1} - Y^*_{t-1}$) in the previous period and the inflation gap (difference between actual and planned inflation in the

previous period: $P_{t-1} - P^T$).¹³ The equation means that the monetary policy will be adjusted automatically, according to the deviations from target values. If monetary authorities can estimate the equilibrium interest rate correctly and adjust the short-term nominal rate to it, the output gap in equation (1) will be closed and inflation in equation (2) will be stable, so that the whole system is in equilibrium.

In Woodford, the natural interest rate assumes a different meaning from that which was proposed by Wicksell. It is not the expected return on real investment, determined independently of the banking system, but the abstract equilibrium rate of interest in the case of complete price flexibility:

‘Wicksell (1898) distinguished between the money rate of interest (as observed) and the ‘natural rate’ of interest, which was the interest rate that was neutral to prices in the real market, and the interest rate at which supply and demand in the real market was at equilibrium. Although it is not self-evident from the model outlined above, this “natural rate” of interest equates savings and investment and does so at a zero-output gap ... [t]he NCM model portrays an economy in which the interest rate can be adjusted to secure equilibrium in terms of a zero output gap and a balance between aggregate demand and aggregate supply (alternatively between planned savings and planned investment).’ (p.16)

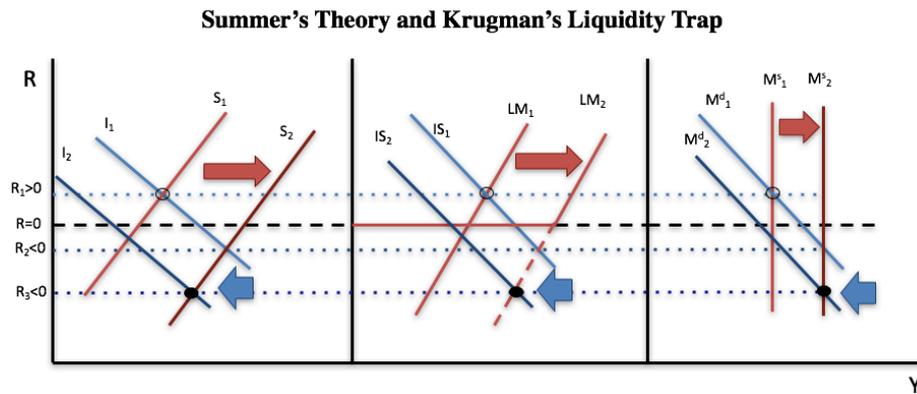
These models seem rather useless for framing the current debate on stagnation. To begin with, there is a question of effectiveness of the monetary policy which, apart from depending on several abstract and unmeasurable variables, is not suited for a context of stagnation, low inflation and zero bound interest rates. Secondly, the NMC framework has a wrong approach to money. Without liquidity restrictions and banks, it is rather difficult for these models to fully capture a world where banks’ endogenous capacity to create money can lead to real imbalances, and real adjustments can affect banks and money creation.

Let us consider Bernanke, Krugman and Summers’ arguments on stagnation; they all agree on the definition of stagnation: a situation in which monetary policy cannot close the output gap by pushing the interest rate to its equilibrium level, since nominal rates are already at the zero bound. Having determined the key variable – the equilibrium interest rate – the question is what can explain its secular decline.

¹³ See Bernanke & Woodford (1997) and Woodford (1999) for more on the determination of the optimal monetary policy and the role the Central Bank in adjusting for past inflation gaps.

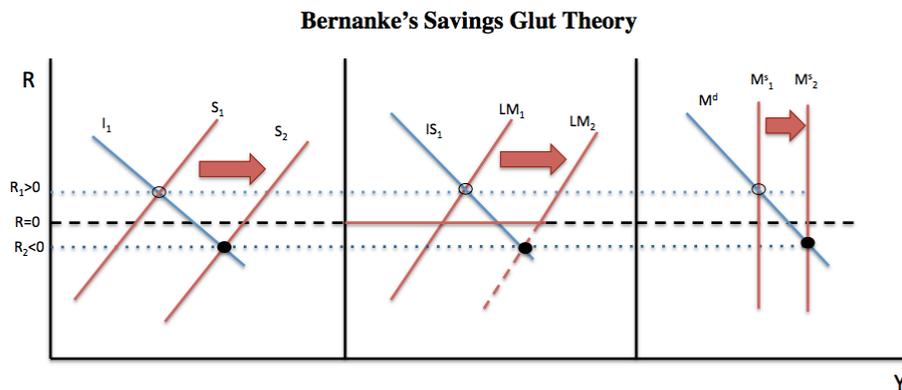
In order to understand how the natural interest rate is determined (according to the arguments outlined above) it might be helpful – as an exercise – to abandon the framework of the new neoclassic consensus (aggregate demand function, an inflation function and a policy function) and go back to the old neoclassic consensus (an investment-saving function and a liquidity preference-money supply function). These simple IS-LM diagrams summarise both approaches:

Figure 9 - Summers' theory and Krugman's Liquidity Trap



Source: Own elaboration.

Figure 10 - Bernanke's Saving Glut theory



Source: Own elaboration.

In Summer's and Krugman's explanations, a decline in investment relatively to saving corresponds to a lower demand for money, which pushes the natural interest rate to negative levels. As a consequence, the output market will not clear. In the case of Bernanke's saving glut, the same mechanism is in place, but it is originated by an increase in saving and money supply, motivated by emerging markets' decisions.

It becomes clear that this discussion has never left the theoretical boundaries of the mainstream consensus, which embodies two theoretical anachronisms: the loanable funds theory and the Wicksellian natural rate of interest (Keen, 2015). The argument is straightforward: demand (investment) and supply (saving) for funds determine the equilibrium, or natural, interest rate which keeps the economy at full employment and stable inflation (operating at the potential output).

To understand where the current analyses of stagnation fail, it is crucial to clarify the relation between saving, investment and the interest rate.

In the *General Theory*, Keynes argued that banks can generate financing, regardless of the pre-existing pool of savings, extinguishing the logical causation between saving and investment. Based on data from US national accounts for 2014, L. Taylor (2016) puts forward two arguments. The first is that private sector saving is not sensitive to interest rates. The second states that private saving does not count much for the determination of a macroeconomic equilibrium. Data is consistent with Keynes's contribution in 'switching the emphasis from interest rate adjustments to changes in income as the key macroeconomic adjustment mechanism' (p.8).

Contrary to what was thought (and still is) in mainstream theory, the relation between saving and investment is of a macroeconomic identity, and not equilibrium. It follows that i) saving cannot be a pre-condition for investment but the result of it and that ii) there is no need for an interest rate to balance two variables that, by definition, match at all times. Something else determines investment (as we will see further on) and something else determines the rate of interest. Hence, there is no theoretical need for a concept such as the natural rate of interest:

'In my Treatise on Money I defined what purported to be a unique rate of interest, which I called the natural rate of interest—namely, the rate of interest which, in the terminology of my Treatise, preserved equality between the rate of saving (as there defined) and the rate of investment. I believed this to be a development and clarification of Wicksell's 'natural rate of interest', which was, according to him, the rate which would preserve the stability of some, not quite clearly specified, price-level.

I am now no longer of the opinion that the concept of a 'natural' rate of interest, which previously seemed to me a most promising idea, has anything very useful or significant to contribute to our analysis. It is merely the rate of interest which will preserve the status quo; and, in general, we have no predominant interest in the status quo as such.' (Keynes, 1936/2008, p.154)

What then governs the interest rate and investment?

As for the interest rate, Keynes's main contribution in the *General Theory* is the liquidity preference theory of interest: ‘... one could regard the rate of interest as being determined by the interplay of the terms on which the public desires to become more or less liquid and those on which the banking system is ready to become more or less unliquid. This is, I think, an illuminating way of expressing the liquidity preference theory of the rate of interest, but particularly so in the field of “finance”.’ (Keynes, 1937c, p.666)

Connecting this idea with the previous saving-investment framework, the interest rate is not a matter of how much society desires or decides to save (or flows of saving), but how it chooses to do it. Hence, it should not be confused with the loanable funds theory:

‘The current rate of interest depends, as we have seen, not on the strength of the desire to hold wealth, but on the strengths of the desire to hold it in liquid and illiquid forms respectively, coupled with the amount of the supply of wealth in the one form relatively to the supply of it in the other.’ (Keynes, 1936/2008, p.136)

Post-Keynesians have long argued that investment does not depend on the interest rate, but upon the capacity utilisation, relative amount of internal funds and profit expectations. Once carried out, investment will generate the profits out of which saving will be constituted. It results that, as pointed by Kalecki, the rate of interest cannot be determined by the demand for and supply of new capital because investment ‘finances itself’. So, as argued by Keynes, saving and credit are not alternatives with different degrees of banking intermediation: credit precludes savings by financing investment and the very creation of money (as debt) constitutes an important element explaining investment patterns.

2.3.3.2. Supply-side theories

Supply side theories of stagnation offer an exogenous explanation for the decline of investment and growth rates. Their argument focuses on the impacts of technology, innovations and state intervention on productivity, measured through the total factor productivity (TFP). Working within the boundaries of the classical dichotomy on the one side, and the ascetic separation between the economic and political spheres, on the other, these theories renounce the possibility of finding the root causes of stagnation inside the functioning of the economic system.

The concept of factor productivity, on which these theses are based, completely excludes the monetary realm from the equation. Not only do banks, or the financial sector, play no visible role in the model, but capital is reduced to its material appearance as a means of production. This theoretical reduction, suggested by Adam Smith (1776/1982), was consolidated during the marginal revolution, particularly in the work of John Bates Clark (1899/1908).¹⁴

The introduction of a production function, determining the level of output based on the proportional marginal contributions of capital, labour and land, allowed this shift. Every factor is treated in the same fashion, with its specific income associated – profit, wage, rent — regarded as the remuneration for its respective marginal utility. Since the latter cannot be directly observable, it can only be translated into the market price of every factor, resulting from demand and supply schedules. Besides providing a pure mathematical model of distribution, the core neoclassical theories kept away all the preoccupations with distribution. Nevertheless, the Marginalist Revolution offered a political justification for profit – the remuneration of capital (Nitzan & Bichler, 2009, p.70).

These unrealistic assumptions are explicit in the adding-up problem. According to the marginal productivity theory of distribution, each production factor is paid according to its marginal product. If true, the sum of payments in money values for each factor of production will exhaust the total product, leaving no room for surplus or deficit in the production process. Wicksteed (1894) used Euler's theorem to show that this result can only be obtained when the production function is assumed to be homogenous of first degree, implying constant returns to scale. The production function must also respect other properties: perfect competition, zero profits in the long run and divisibility of factors of production. These are obviously unrealistic assumptions. Pullen (2009, p.136) describes several attempts to avoid the constant returns requirement, or even the use of Euler's equation. Nevertheless, the assumption of perfect competition has remained part of the theoretical solution to the adding up problem.

¹⁴ 'It is the purpose of this work to show that the distribution of income to society is controlled by a natural law, and that this law, if it worked without friction, would give to every agent of production the amount of wealth which that agent creates' (Clark, 1899/1908, p.V).

The adding-up problem does not exhaust all criticism that the marginal productivity theory of distribution has received, namely by Robinson (1953, 1970), Kaldor (1955), Sraffa (1960/1975) and Dobb (1973). In fact,

‘The basic difficulty with the whole approach does not lie, however, in this so-called “adding-up problem” but in the very meaning of “capital” as a factor of production. Whilst land can be measured in acres-per-year and labour in man-hours, capital (as distinct from “capital goods”) cannot be measured in terms of physical units.’ (Kaldor, 1955, p.90)

The measurement problem refers to the fact that there is no technical or natural unit measure for capital. Furthermore, the variety of capital goods implies that its aggregation can only occur in terms of exchange (or monetary) values. It has been argued, as a response, that aggregation is dispensable by calculating individual rates of return. However, even if it was possible to identify and compute all individual components, the aggregate or social rate of return of capital would not avoid the fact that aggregation can only take place using exchange values. This logical argument exposes the circular reasoning that pervades the marginal productivity theory of distribution: profits, as income associated to capital, are explained as a function of capital’s marginal productivity. However, any quantity of capital can only be measured as the present value of its expected future profit.

The disentanglement problem has also been the source of much controversy. At its heart is the question whether the marginal product is a mono or multi causal phenomena and, in the likely case of the latter being true, how can individual factor contributions be disentangled. It has been argued that there is no need to know the contributions of each factor (or the specific product of every factor), only their marginal products, or rates of return. This argument escapes the disentanglement problem by falling in the circular trap: in the end, what the theory tries to explain is the explanation itself. The distribution theory can describe the result of the distribution process but offers no actual (normative) theory to explain distribution.

A more sophisticated response came from the general equilibrium models (GEM), with simultaneous equation price systems and disaggregated marginal productivities, which are supposed to solve both the circularity and aggregation problems. They represent, according to Cohen and Harcourt (2003), the neoclassical retreat from its parables. Some of the theoretical flaws of modern general equilibrium models have already been

mentioned, and usually involve many unrealistic assumptions.¹⁵ Apart from that, two of its most criticised features are, on the one side, the concept of equilibrium as the achievable outcome of the model and, on the other, the static nature of the analysis between equilibrium points. ‘Their most important problem, though, comes not from what they try to explain, but from what they ignore, namely capital. Their emphasis on disaggregation, regardless of its epistemological feasibility, is an ontological fallacy. The social process takes place not at the level of atoms or strings, but of social institutions and organisations.’ (Nitzan and Bichler, 2009, p. 81)

Despite its flaws, the neoclassical production function is at the heart of the models that shape the current thinking on stagnation. One of the main elements of that framework is the concept of output gap¹⁶: ‘basic macroeconomics provides a three-pillar framework for thinking about an economy’s future growth. First is the economy’s long-run potential growth rate. Second, is the deviation of the actual growth from its potential. Third is one-off changes in the level of GDP without a change in the long-run growth rate.’ (Tuelings and Baldwin, 2014, p.3)

Today, the IMF defines potential output as ‘the maximum amount of goods and services an economy can turn out when it is most efficient—that is, at full capacity’ (Jahan & Mahmud, 2013). It is, according to the European Commission, ‘a summary indicator of the economy’s capacity to generate sustainable, non-inflationary, growth whilst the output gap is an indication of the degree of overheating or slack relative to this growth potential’ (Havik et al., 2014, p.4).

There are two main methodologies to estimate the potential output. Univariate methods use statistical filters to extract trends out of historical time-series. The trend method implies making statistical assumptions on the time-series properties and their hypothetical correlation with the cycle, and has been criticised by its lack of strong economic foundations. The multivariate method, on the other hand, implies the construction of a production function capable of estimating the supply potential of an economy.

In order to assess the practical impact of this discussion, it is worth analysing the European’s Commission methodology to estimate potential output, which plays a central

¹⁵ See Ackerman, Nadal, & Gallagher (2004) for an overview of the theoretical flaws of GEM.

¹⁶ Difference between the actual and potential output.

role in the determination of fiscal and economic policies. The model is based on a production function, and it is assumed that:

‘This latter approach focuses on the supply potential of an economy and has the advantage of giving a more direct link to economic theory, but the disadvantage is that it requires assumptions on the functional form of the production technology, returns to scale, trend technical progress (TFP) and the representative utilisation of production factors.’ (Havik et al., 2014, p.9)

The functional form chosen for the production function has the specification of a Cobb Douglas equation:

$$Y = (U_L L E_L)^\alpha (U_K K E_K)^{1-\alpha} \quad (5)$$

or

$$Y = L^\alpha K^{1-\alpha} TFP \quad (6)$$

The interpretation is straightforward: potential output results from a combination of factor inputs – labour (L) and capital (K), corrected for the degree of excess capacity (U_L , U_K), adjusted for the level of efficiency.

As referred above, this function requires the assumption of constant returns to scale and factor price elasticities of one. As for the output elasticities of labour and capital, ‘under the assumption of constant returns to scale and perfect competition, these elasticities can be estimated from the wage share’ (p.10).

The TFP is estimated from the Solow residual, like in most neoclassical approaches. Its detrending is obtained through a bivariate Kalman filter, which tries to extract the cyclical component of productivity – capacity utilisation – from its trend – efficiency. The former is assumed to vary according to economic conditions, while the latter has ‘no empirical relevance, since efficiency is not measured’ (p.32).

Finally, it is important to discuss the rationale behind the Solow residual. Abramovitz, (1956) named it the ‘measure of our ignorance’, since the total factor productivity (or the Solow residual) is simply the portion of the estimated output that is not explained by the amount of inputs used in production. Denison & Poullick (1967) measured the dynamics of economic growth in several countries and found out that, in the USA, for instance, between 1950-5 and 1955-62, the residual was responsible for 30% to 45% of growth. When comparing the results between the US and Europe, he concluded that ‘the main positive statement that can be based upon them is that sources for which no specific

estimate was made was responsible for a large difference in output per man between the European countries generally and America. My view is that the residuals are accurate enough for their large size to support this statement.’ (p.291)

In a simple Cobb Douglas production function, the Solow residual is usually given by:

$$SR = gY - \alpha \cdot gK - (1-\alpha) \cdot gL \quad (7)$$

The measure is considered to be accurate only if the production function is neoclassical, there is perfect competition in factor markets and growth rates of inputs are estimated correctly. In the European Commission’s methodology there is an actual estimate of the utilisation capacity. However, the unknown element – efficiency – is still a measure of ignorance.

2.4. Final Remarks

The present analysis does not ignore that mainstream economics has evolved since the marginalist revolution. Many of today’s complex models avoid some of the more restrictive assumptions in the old Walrasian and Marshallian neoclassical traditions. Furthermore, it should be noted that the NMC proposition regarding the auto sufficiency of monetary policy to adjust demand to potential output has been questioned by Krugman’s or Summers’s approaches.

Nevertheless, contrary to the view of Colander, Holt, & Jr (2004),¹⁷ mainstream theories of stagnation did not succeed in breaking with some of the most powerful ideas underlying neoclassical thinking, challenged in the classical dichotomy and capital controversies debates: methodological individualism, systemic stability and a non-credit money view. In different ways, both Wicksellian and supply side theories of stagnation ignore the political and institutional character of the capitalist system and misconceptualise money.

Wicksellian theories rely on an abstract concept – the natural interest rate –, supposed to equilibrate saving and investment, to build up the zero lower bound argument. The theoretical structure underpinning it reveals, as shown, an erroneous understanding of the role of money. The relation between investment and financing is not properly grasped,

¹⁷ ‘mainstream economic thinking has changed. (...) [E]conomics is moving away from a strict adherence to the holy trinity – rationality, selfishness, and equilibrium – to a more eclectic position of purposeful behaviour, enlightened self-interest and sustainability’ (Colander et al., 2004, p.1).

and neither are explicitly considered. The classical dichotomy holds, in the sense that the demand – monetary side – does not interfere with the structural conditions for the formation of output. These theories have little to say about how institutions, and the existing relations of power, influence investment and distribution.

In the case of supply side theories, the ascetic nature of its underlying assumptions is even more striking. From perfect competition to the neoclassical production function, the positive distribution theory in its root ignores the ‘commercial, social and political influences and the fortunes of the class war’ (Bhaduri & Robinson, 1980, p.111). Furthermore, as identified above, ‘the natural or potential rate of growth in modern discussions about secular stagnation seems to be more or less independent of aggregate demand dynamics’ (Hein, 2015a, p.9).

One final and obvious conclusion is that the current mainstream debate completely overlooked the importance and diversity of the historical debate on stagnation. Mostly hidden in heterodoxy, there are efforts to provide endogenous and realistic explanations for why full employment growth is not to be the natural result of the functioning of capitalist economies.

From the seminal contributions of Hansen, Keynes and Kalecki, stagnation has been considered a feature of mature capitalism, the result of prevailing accumulation regimes. Concentration and accumulation are seen as intertwined processes, that Kalecki and Steindl try to understand and explain through the concept of monopoly power. The disproportional share of surplus value obtained by oligopolies reveals a disruption in the production and distribution process that affects the (hypothetical) normal functioning of capitalism. Stagnation emerges as a problem of distribution, that results in excess saving by the capitalist class, insufficient investment or under consumption by the working class. These contributions are reviewed in detail in the next section.

3. Theories of stagnation lost in heterodoxy

3.1. Introduction

This chapter comprehensively reviews the historical debate around stagnation, which was ignored in the current mainstream discussion.

The historical contextualisation in section 3.2 shows how stagnation has been a constant concern in heterodox economic thinking. On the contrary, mainstream interest on the theme has been superficial and short-termed. Hansen's famous theory of secular stagnation is described in section 3.3. In section 3.4, Keynes' main works are reviewed in order to establish the existence of an implicit theory of stagnation, as suggested by Schumpeter. Section 3.5 analyses Keynes' theory of declining marginal efficiency of capital through the lenses of Kalecki' investment theory, with particular emphasis on the principle of increasing risk and degree of monopoly. Both concepts are developed in section 3.6, when reviewing Steindl's theory of stagnation in mature capitalism. The next section looks into Paul Sweezy's and the Monthly Review authors' theory of stagnation in the context of the monopoly capitalism theory. It should be noted that Sweezy's theory of stagnation after *Monopoly Capital* adopts an underinvestment – failure to invest on a sufficient scale – view, as proposed by Keynes, Kalecki and Steindl. This perspective represents an evolution from those Marxist theories of stagnation based on an underconsumptionist – failure to ensure sufficient levels of wages and employment – view. In section 3.8 other perspectives within the post-Keynesian and Kaleckian theories of distribution and financialisation are reviewed. The chapter closes with a quick overview of the main empirical studies on financialisation and stagnation.

These theories have different characteristics, depending on the historical and theoretical context of their authors. Nevertheless, they converge into one core idea – stagnation is the result of the endogenous functioning of the capitalist system. As the system develops, financial and industrial capital become more concentrated. The accumulation strategies of these large conglomerates determine an intrinsic maldistribution of surplus, not only between capital and labour, but also within the corporate sector, that affects investment and aggregate demand. Supply and demand are not separate processes, and finance is introduced in the system as an *ex-ante* condition for production, concentration and accumulation. Finally, it is worth noting that, in heterodox theories of stagnation, individuals are not indistinct economic units; there are different classes – workers and capitalists –, depending on one's position within the productive system. Economic outcomes depend on the relations between and within classes, their relative powers, interests, strategies and influence over institutions.

3.2. Historical Context

The core of the debate on stagnation is usually placed in the aftermath of the 1929 financial crash in the USA. The recession lasted for years, with unemployment reaching its peak of 24,9% in 1933. Despite the hopes for recovery, the double-digit unemployment rate persisted throughout the decade and a new downturn arrived in 1938-1939.

Such context was propitious to question the existing business cycle theory, which predicted a quick and automatic recovery after the slump. Alvin Hansen, Joseph Schumpeter and John Maynard Keynes were notorious participants in the debate.

Schumpeter saw Hansen's and Keynes's secular stagnation theories as 'theories of vanishing investment opportunities' (Schumpeter, 1939/2011, p.1033): modern economies have an immense saving capacity; however, in absence of profitable investment opportunities, instead of accumulation of real capital, we will get depression, unemployment and lower growth. Keynes anticipated some of Hansen's arguments but has never formulated a concrete theory of stagnation. Nevertheless, he was responsible, according to Schumpeter, for the development of 'the relevant type of stagnationist theory' (Schumpeter, 1942/2008, p.392).

Hansen attributed the vanishing investment opportunities to structural and secular changes in the USA after the 1930s: i) decline in the population growth; ii) end of geographical expansion and iii) technological changes that made production less capital intensive. Keynes emphasised the effect of population decline, as well as other structural factors, on the long-term efficiency of capital and increasing the overall saving rate.

In the last chapter of the second volume of *Business Cycles* (1939/2011) and, later, in his *Capitalism, Socialism, and Democracy* (1942/2008), Schumpeter openly criticises both stagnation theories, with special focus on Keynes's work:

'The Stagnationists are wrong in their diagnosis of the reasons why the capitalist process should stagnate; they may still turn to be right in their prognosis that it will stagnate with sufficient help from the public sector.'
(Schumpeter, 1942/2008, pp.424-425)

Nonetheless, Schumpeter diverged from the regular conservative argument at the time. The problem was not New Deal itself, but the anti-business spirit of the people implementing it – the bureaucratic arteriosclerosis that depressed business activity.

Just when the academic (and political) debate on the subject became louder, the Second

World War broke out, and the whole discussion was forgotten.

After the war, in 1952, Steindl published his masterpiece, *Maturity and Stagnation in American Capitalism* (Steindl, 1952/1976). The book was finished in 1949, when recession was back to the US, just before the new impulse given by the Korean War. In his review of Steindl's book, in 1954, Hansen seemed surprised by how little attention the work had deserved: 'It is amazing how many economists have been able to close their eyes and blandly announce that events since 1940 have *disproved* the stagnation thesis!' (Hansen, 1954, p.409). In his opinion, there were three theories of stagnation worth considering: i) one based on exogenous factors, such as his own; ii) one based on social changes, such as the role of State or trade union intervention, developed by Schumpeter; and, iii) one based on endogenous factors, inherent to the development of capitalism, which is, obviously, Steindl's theory of stagnation in the context of oligopoly capitalism.

Despite the importance of these three contributions, the topic went – again – out of the spotlight. In the 1970s stagflation came along with the rise of neoliberalism and the Great Moderation. It was the end of inflation in Europe and the US, but capitalism failed in delivering satisfactory levels of employment, investment and, above all, stability. Notwithstanding, the issue did not raise much attention until the Great Recession. The exception were those economists writing under the influence of Steindl, Kalecki and Keynes – often denominated post-Keynesians — and Marxists, such as Baran and Paul Sweezy, working within the theory of monopoly capitalism.

From the 1970s until the Great Recession, the debate over the stagnant and unstable nature of capitalism was mostly an exclusive of heterodox economics. Within this large and diverse category, one can find very different approaches to the problem, but also some common ideas.

There is the broad recognition that the capitalist system suffered a structural change in the 1970s. Generally, it is accepted that, between 1945 and 1975, the global economy lived in a virtuous cycle of full employment sustained by wage growth and financial and economic regulations (Palley, 2015). In the 1980s this consensus was discarded and replaced by the neoliberal model of the New Consensus. Inflation targeting replaced all previous macroeconomic management instruments and fiscal policy lost importance relatively to its monetary counterpart. In this new framework, labour rights started to be presented as constraints to wage adjustments. The resulting programme of deregulation of labour markets broke the existing link between productivity and wage growth.

Consumer debt came as an alternative to sustain living patterns and macroeconomic demand.

The neoliberal strategy required the exposure of workers and local economies to globalised markets and financial liberalisation. Together, they have changed the balance of power between labour and capital drastically, offering unprecedented conditions for concentration of capital. The liberalisation of international financial and trade flows was responsible for the growth of international imbalances (Stockhammer, 2012a).

The term *financialisation* appeared to describe the growing importance of the financial sector in the economy. Epstein defines the financialisation as ‘the increasing role of financial motives, financial markets, financial actors and financial institutions in the operation of domestic and international economies’ (Epstein, 2006, p.3).

Finance has spread across different sectors of modern societies, multiplying its actors and instruments. In the process, financial systems suffered substantial mutations: the shadow system became larger and stronger; regular banks turned to investment banking activities, more dependent on fees and increasingly leveraged; large corporations started to have direct access to capital markets, and families became the largest clients of commercial banks (Erturk & Solari, 2007; Lapavitsas, 2009).

Apart from describing this process, the literature also focuses on the implications of financialisation. In general, these studies follow one of three different approaches.

The first refers to financialisation as the emergence of a new regime of capitalist accumulation. By weakening the power of labour, neoliberal policies created a demand gap that threatened the previous pace of accumulation. Debt appeared as a solution to fill out that gap on the consumer side, while financial activities replaced the lack of investment opportunities on the firms’ side.

The second approach is related to the impact of finance on corporate governance and investment decisions. It develops mostly around two channels: the crowding out effect and the financial payments effect.

Finally, the third approach considers the financialisation of everyday life, emphasising the appropriation by finance of larger aspects of personal and social life: housing, education, health or elderly support, and its impacts on income inequalities.

Within this general context, one can find different developments in heterodox theory. In the Marxist tradition, Paul Sweezy and Paul Baran developed the ideas of Kalecki and Steindl and created a more complete theory of investment in the context of oligopolised and financialised economies. This position implied an evolution from the underconsumptionist theory of stagnation defended by Sweezy before *Monopoly Capital*, that had implied a retrogression to Ricardian principles. According to Toporowski,

‘Those fundamental principles were the labor theory of value (from which the Ricardian socialists derived their case for socialism as the right of labor to its products) and underconsumption as the cause of poverty in capitalism, because workers were not paid the full value of their labor, and therefore could not buy all that they produced. [And] this is why many Marxists were caught unawares by the increasing prominence of finance in the early years of this century, and why the theories of ‘financialization’ that emerged from this Marxist analysis combine classic capitalism with underconsumption, reinforced by a Ricardian view of debt in which debt is never an asset, as it is in a credit system, but merely a usurious claim on income’ (Toporowski, 2016a, para. 17).

The underconsumptionist view has been reconstructed under the new theories of wage-led growth, advocated by Engelbert Stockhammer and Ozlem Onaran. Wage-led theories make use of Kaleckian insights on the functional distribution of income to argue that changes in the wage share of income have undermined demand and, as a consequence, growth. The solution is, therefore, a wage-led recovery.

Post Keynesian/Kaleckian theories, on the other hand, look into the effects of income distribution on growth and accept the importance of wages to sustain demand, but maintain Keynes’s and Kalecki’s idea that investment determines the cycle.

3.3. Hansen’s theory of secular stagnation: half exogenous, half Keynesian

Alvin Hansen, born in 1887, came to be known as the American Keynes and left a life work dedicated to the study of business cycles. His work was theoretical, statistical and historical, and he tried to apply it, very much like Keynes, to solve the economic problems of that time.

Cycles of Prosperity and Depression (1921/2010) was his first empirical study. At the time Hansen believed that changes in money and credit determined movements in the cycle. This idea did not last and ended up being replaced by a theory based on exogenous

factors. Nevertheless, he never discarded the use of the accelerator, and the view – popular among cycle theorists like Schumpeter, Wicksell, and Keynes – that investment decisions are determinant to the cycle.

Business-Cycle Theory: Its Development and Present Status (1927) already reflected some of the foundations of what was to be known as the secular stagnation theory, developed in his presidential address to the American Economic Association, which was delivered in Detroit on the 28th of December 1938 and published under the title ‘Economic Progress and Declining Population Growth’ in the March 1939 issue of the *American Economic Review*.

Based on the ideas of Albert Aftalion and Arthur Spiethoff, Hansen analysed external forces, such as waves of technological innovation, population changes and territorial expansion as the root causes of the cycle. These forces raised profit expectations which induced investment, favoured by the dynamic effect of the price system, which allocated resources into those sectors with higher profit expectations. The tendency of a free enterprise system was, according to Hansen, to achieve full employment. However, the system was also subject to negative forces, such as credit crises, that would give rise to a cumulative process of recession until a new external force puts the system back on track. In sum, these external factors were the drivers of growth and accumulation and, therefore, smoothers of the sharp business fluctuations. The centre of Hansen’s theory was the adjustment of the economy to new waves of technological innovation through the correct function of the price mechanism. However, he did not disregard the role of private and government spending entering the economy. Later, he came to admit that government spending was a crucial element of a much-needed ‘anti-cyclical programme’ (Hansen, 1947).

The idea of stagnation due to lack of profitable investment opportunities and technical innovations was mentioned for the first time in 1934, in ‘Capital Goods and the Restoration of Purchasing Power’. In his speech, delivered in 1938, the role of population decline assumed a larger role than in previous writings. This change might reflect the ideas put forward by Keynes in the seminal Galton Lecture, delivered to the Eugenics Society in 1937 (Keynes, 1937b), on the effects of population growth decline on investment: when population growth decreases, investment opportunities will also

decrease, and as saving rises with the ageing of the exiting population, the economy will end up in a low-growth equilibrium, with underemployment.¹⁸

After a first sceptical reaction to Keynes's General Theory, published in 1936, Hansen's acceptance of the ideas proposed by the British economist is well reflected in his Presidential Address in 1939. Most likely, the failure of the promised recovery after the Great Recession has also contributed to consolidate Hansen's views on the matter.

He starts by identifying three common factors of economic progress in classic thinking: technological innovations, expansion to new territories and natural resources, and population growth. The relation between economic progress and instability came in the late Nineteenth Century. Before that, the prevailing idea, largely influenced by the historical conditions of the Eighteenth and early Nineteenth centuries, was that the economies would remain in a stage of equilibrium with full use of the available resources.

According to Hansen,

‘Not until the problem of full employment of our productive resources from the long-run, secular standpoint was upon us, were we compelled to give serious considerations to those factors and forces in our economy which tend to make business recoveries weak and anaemic and which tend to prolong and deepen the course of depressions. *This is the essence of secular stagnation – sick recoveries which die in their infancy and depressions which feed on themselves and leave a hard and seemingly immovable ore of unemployment* [emphasis added].’ (Hansen, 1939, p. 333)

Hansen's main goal was not to discuss the impact of investment in output and full employment of factors, since ‘it is accepted by all schools of current economic thought that full employment . . . cannot be reached in the modern free enterprise economy without a volume of investment expenditures adequate to fill the gap between consumption expenditures and that level of income which could be achieved were all the factors employed.’ (p. 334) The idea was, instead, to discuss the chances of capital formation to secure the necessary use of productive factors, given the prevailing levels of technology, population growth and geographical expansion. It must be highlighted that, according to Hansen, these were the dominant determinants of investment and employment, contrary, for example, to the role played by the interest rate, which ‘has occupied a larger place than it deserves in our thinking’ (p. 334).

¹⁸ Hansen (1939) actually refers to Keynes lecture in a footnote in page 335.

Hansen makes use of Hawtrey's (1937) distinction between capital deepening and capital widening¹⁹ to argue that, in the previous fifty years, capital formation consisted in a widening of capital or, at least, that the deepening of capital in certain areas was not enough to compensate for capital saving innovations in other sectors, therefore reducing the ratio of capital to output. Three factors contributed to this outcome.

First, population growth, for it affects capital widening through its impact in final output; but it also affects capital deepening, which depends on three aspects: cost reducing innovations, reductions in the rate of interest and changes in the character of output. The rate of population growth must necessarily affect the type of demand and, therefore, the capital requirements of final output. An ageing population, for example, must require more personal services and less residential buildings, so one can expect that such development must lead to a decline in the ratio of capital to output. On the other hand, population growth has also an indirect influence on the volume of capital formation, through its impact on the expansion of new techniques.

The second factor is the opening of new territories, which is largely intertwined with population growth. Both were 'responsible for a very large fraction – possibly somewhere near one half – of the total volume of new capital formation in the nineteenth century' (Hansen, 1939, p.338). Since Hansen did not see many possible opportunities in exporting investment, given his analysis of the current state of the new industrialising countries, he was forced to conclude that the opening of new investment outlets was mostly dependent on the progress of technology through the development of new techniques of production.

Finally, the third factor is technological progress. According to Hansen, the development of great new industries and revolutionary techniques comes in big waves. Once the new industries are exhausted and the breakthrough techniques become generalised, it may take a long time before the world has the chance to see something similar. Meanwhile, the simple replacement of capital might not be enough to kick off the economy. This view was mostly influenced by Spiethoff's idea that, once the demand for investment is satisfied, its rate and level must decline.

Under a regime of 'vigorous price competition' one could expect that new cost-saving techniques would constantly break through, filling the need for new investment outlets.

¹⁹ Capital deepening means that more capital is used per unit of output while capital widening means that capital increases *pari passu* with output.

However, there are factors blocking such tendency: trade unions, trade associations and, mostly, the development of monopolies.

What can then be done to maintain full employment under such external conditions? Hansen admitted that public expenditure – in the form of investment programmes and tax cuts – financed through taxation or borrowing could contribute to that end. But he was also conscious of the political and economic risks of that strategy, mostly the harm that it could impose to the ‘system of free enterprise’. It is worth noting that this view regarding public intervention through fiscal instruments was already a crucial break with his previous orthodox idea that corrective measures should wait until the depression had operated as a ‘beneficial liquidator’ in the economy (Hansen, 1932, p. 189).

Contrary to the reality of early Nineteenth Century, when the growth of capital accumulation was fast but limited to the existing net saving, in a mature economy the stock of capital is vast, the marginal efficiency low and investment is limited by aggregate demand.²⁰ However, because Hansen did not follow two of the classic arguments — i) that investment opportunities were practically unlimited, so the capital stock could increase as long as the interest rate fell; and ii) that this fall in the interest rate would discourage capital accumulation and promote a smooth passage into a circular-flow economy –, his view of the stationary state, or the circular-flow economy, where consumption equals net income, did not include a full-employment equilibrium, but quite the opposite.

Hence, in Hansen’s theory, secular stagnation became increasingly associated with the notion of underemployment equilibrium.²¹

This is not to say, however, that Hansen came to share Keynes’s ideas on stagnation and investment. He acknowledged the possible effects on the cycle caused by changes in liquidity or nominal wage rigidity but rejected the emphasis on the influence of institutional and psychological factors, and even of the interest rate on investment (instead of *real* factors). More importantly, ‘Hansen’s secular stagnation concept had nothing to do with the notion – often ascribed to Keynes – that the problem is caused by the fact that ‘rich people save proportionally more’, so that the marginal propensity to consume is lower than the average propensity, with a declining ratio of consumption demand to

²⁰ This idea was rejected by Knight (1936, 1944), who argued that the very process of capital accumulation would create the conditions to avoid diminishing returns and, therefore, any limits to aggregate demand.

²¹ See Backhouse & Boianovsky (2015, p. 10) for an account on the evolution of Hansen’s association between secular stagnation and underemployment equilibrium.

income as income grows.’ (Backhouse & Boianovsky, 2015, p.11)

According to Hansen, the Keynesian consumption-income schedule could only hold in the short run, but that is not to say that demand management, mostly through fiscal policy, is not needed both in the short run, as an anti-cyclical device, and in the long-run, as a way for the economy to achieve its potential growth. This idea is clearly elaborated in Hansen’s article in defence of a cycle policy in 1947:

‘Recent discussions indicate that it is high time that we revert to a serious study of the business cycle and the factors which underlie it. It is, indeed, true that structural reforms and adaptation to changed conditions are highly important for the functioning of the economy ... But is it not true that these secular adjustments can prevent the short-run fluctuations of the business cycle ... It is, indeed, true that a long-run program of planned expansion will minimize the violence of the cyclical fluctuations ... But even with a planned long-run program of expansion the primary fluctuations in private investment would still remain to plague us ... It is indeed true that it is not sufficient to “iron out the cycle.” That might only result in stabilized stagnation and unemployment. A long-range program of expansion, structural changes in wage-profits relationship, and in the distribution of income, are necessary.’ (Hansen, 1947, pp.61-62)

However, for those situations in which a long-term expansion program is not suitable, what is needed is a cycle policy, quick and effective, composed of an expansion of public spending – in housing, public works, development projects – and a flexible tax system²².

Due to his focus on fiscal policy as a remedy for both the short and the long run economic problems, Hansen demarcated himself from other stagnationists, like Steindl, who ‘tend to the view that the incapacity of the economy adequately to “generate its own steam” stems from malfunctioning of the price system. The remedy must therefore be sought in reducing the interferences imposed upon a free price system by trade unionism, labor reformism, and state interventionism (Schumpeter) or by the elimination or amelioration of monopolistic and oligopolistic distortion of free, competitive price relationships (Steindl).’ (Hansen, 1954, p.413)

Hansen did not elaborate on the theoretical alternatives to his own stagnation hypothesis. Nevertheless, it should be pointed out that the ‘remedies’ mentioned in the above quotation are, in fact, contradictory, in the sense that, while Schumpeter located the

²² The benefits of the flexibility of discretionary changes in taxes and spending to respond to economic fluctuations were developed in detail in Hansen (1941/2010).

problem in State interventionism, the core of Steindl's theory is that the free functioning of the capitalist market will lead to situations of monopoly and, therefore, stagnation.

3.4. Keynes vs Schumpeter: to be or not to be a stagnationist

There is no consensus whether Keynes's work, and the *General Theory* in particular, contained a view on stagnation or not. This specific debate faded away, together with the whole discussion on stagnation, with the growth prospects after World War II. Guthrie & Tarascio (1992) comprehensively reviewed the long debate on this controversy.

At the beginning we have the thesis, put forward by Schumpeter (1942/2008), that not only does Keynes's General Theory comprise a clear stagnationist view, but also that this view was completed by 1919. Schumpeter finds evidences of the modern stagnation thesis, that he argues is also the foundation of the *General Theory*, in *The Economic Consequences of Peace* (1919/2015). In fact, the extract chosen to illustrate his case contains some of the arguments later found in Hansen's stagnation theory: the exhaustion of the economic conditions that prevailed before World War I, which allowed for an efficient absorption of savings — such as population growth, access to new materials and markets, unprecedented international mobility of capital. According to Schumpeter, there is a progression in the analytical development of the initial idea, already present in the *Economic Consequences*, that economic problems would arise from diminishing investing opportunities in face of the bourgeoisie's persisting saving habits. The *Tract on Monetary Reform* (1923/2015) and the *Treatise on Money* (1930/2015a) were, somehow, pre-stages of the complete analytical and theoretical setup found in General Theory.

In *Capitalism, Socialism and Democracy*, Schumpeter classifies the latter contributions of Keynes as the 'relevant type of stagnationist theory' (1942/2008, p.392). Its centre is the psychological law, stating that 'high income means high savings and since these savings will not be entirely offset by investment expenditure, it will not be possible for the economy to keep on that high level of income and employment (...)' (p.394). Schumpeter dismisses this proposition by arguing that hoarding is a consequence of depressions and, therefore, cannot be seen as its main cause. In chapter X, Schumpeter discusses the first part of Keynes and other stagnationist views based on the exhaustion of investment opportunities and rejects its main points one by one. Not only 'objective

opportunities are not lacking’, but there is no reason to think of an ‘historical discontinuity’ in the pace and form of accumulation.

Schumpeter’s position on stagnation can be summarised in the following sentence:

‘the theory that the capitalist process is stagnating from internal causes inherent to its logic and that income generation by government is nothing but the self-defence of a shrivelling organism, is therefore a complete misfit – at best a mistaken interpretation of certain aftereffects of the world depression, at worst the product of wishful thinking on the part of all those who crave for a presentable basis for policies they approve’ (p.394).

Schumpeter recognised that, in order to survive, capitalism needs to perform constantly, and considered that any ‘attempt to run capitalism in an anticapitalistic way’ could damage that end. Four types of intervention were damaging the economy in the 1940s. Firstly, the permanent and unjustified raise in direct taxation, which diminished the incentive to invest and contributed to a shortage in the supply of capital. The second was the concomitant raise in the taxation on capital gains and retained earnings that promoted dissaving, and limited accumulation and investment capacity. The third relates to all legislative changes that raised the costs of labour. Finally, industrial policies that were unfavourable to private initiative, mostly connected to the constant and unpredictable threat of public initiative and its effects on the normal course of business, were implemented. ‘The case thus serves to show not only how unrealistic any theory of investment opportunity is which leaves the political factor out of account’ (Schumpeter, 1939/2011, p.1044). Additionally, there was the danger that hostility towards monopoly power might undermine economic progress.

This idea is based on the argument that oligopoly and large-scale business were behind the performance and technological achievements of capitalism in the Nineteenth Century (Schumpeter, 1942/2008, p.105). Schumpeter discards free competition based on two arguments: it does not reflect the reality and it is not the most efficient form of organising the system of business enterprise. He goes further, arguing that price restrictions and abnormal profits are not the faults of an otherwise efficient system of free competition capitalism, but the best long-term strategy to accumulate and avoid severe depressions.

All around, the argument is that these anticapitalistic policies have created an atmosphere contrary to the flourishing of entrepreneurship and private initiative, and are the main causes for investment opportunities vanishing in the 1930s. Later, in his last and unfinished work, *The March into Socialism*, Schumpeter (1950) reinforced his attacks on

Keynes's stagnationist view and its remedies: 'The stagnationist are wrong in their diagnosis of the reasons why the capitalist process should stagnate; they may still turn out to be right in their prognosis that it will stagnate with sufficient help from the public sector' (Schumpeter, 1950, p.456).

Alan Sweezy (1947/2010) had a very different interpretation of Keynes's work. He claimed that, in *Economic Consequences and Tract*, Keynes was concerned with the lack of saving, which should be encouraged, and with the pernicious effects of monetary instability on the animal spirits. The hypothesis of declining investment opportunities and its impacts in terms of accumulation were not in Keynes's mind until around 1935. Keynes's stagnationist view came with *General Theory*. Later, Paul Sweezy (1964) admitted that although Keynes's theory showed that, in the event of declining investment activity, capitalism would tend to stagnation and decline, he never managed to consistently show why should the inducement to invest decline. Hence, Keynes's stagnationist view was more likely to be based on an intuition. Harris (1947/2010) shared this vision and stated that only in 1936 did Keynes present some of the factors threatening capital accumulation, namely, the lack of demand for capital, the excessive rate of interest and the declining marginal efficiency of capital. In 1937, these conditions were systematised in a more consistent theory of stagnation, on a paper in *Eugenics Review* (Keynes, 1937b). Along the same lines, Williams (1948) argued that before *General Theory* Keynes was concerned with normal variations in the business cycle but not yet with a chronic problem of unemployment and accumulation. Klein (1966) argues that Keynes's system does not necessarily imply a pessimistic outcome; it all depends on the economic situation of the moment.

Lekachman (1964) distinguishes between two Keynes. One is more optimistic on the healing powers of economic policy to save capitalism; the other, which precedes the optimistic one, is less confident on the prospects of capitalism, and more radical. For Minsky (1975), *General Theory* was an endogenous theory of the business cycle in which instability and the accumulation of imbalances are inherent to the system. Like Hutt (1963) – who was critic of Keynes –, he charges Keynes for being inconsistent with his own claim of novelty, trespassing in some chapters of *General Theory* the old idea of a structural tendency to declining investment and stagnation. Joan Robinson explicitly refers to a stagnation thesis in Keynes: 'If in reality the distribution of income between workers and capitalists, is such as to require a rate of accumulation which exceeds the

rate of increase in the stock of capital appropriate to technical conditions, then there is a chronic excess of the potential supply of real capital over the demand for it and the system must fall into chronic depression.’ (Robinson in Luxemburg (1913/1968, p. 26).

Skidelsky (1975), like Schumpeter, saw in Keynes a consistent and permanent concern over the changing growth prospects of the Twentieth Century, linked with vanishing investment opportunities. Finally, Patinkin (1976) found no concern in Keynes over the issue of long run growth, whether Tarascio (1971) claims the opposite: Keynes was concerned with underemployment as the long run effect of lack of demand, even if the causes for demand shortage change in his writings.

Like most authors reviewed, Guthrie & Tarascio (1992) conclude that although Keynes acknowledged the ongoing structural transition in the economy already by 1919, it was not until 1925 that this idea was connected to a permanent lack of growth. Schumpeter’s first thesis is therefore confirmed. As for thesis two, ‘the documents from 1925 (perhaps even 1922) onwards reveal that Keynes clearly considered diminished economic growth to be *one part* of the structural transition to which mature economies in the twentieth century would have to adjust’. (p.397) Hence, like Schumpeter, Lekachman and Skidelsky, Guthrie & Tarascio see a connection between structural change and stagnation in Keynes’s writings.

In order enlighten this controversy, Guthrie & Tarascio (1992) surveyed twenty of Keynes's writings, from 1919 to 1943. The results were rather puzzling, especially in some specific periods when ‘Keynes presented differing analyses of the situation to different audiences’ (p.390). Apparently, his urge to raise the animal spirits and to convince the audience about possible policy remedies led him to some level of optimism regarding the future prospects of the economy, which was not reflected in his own analytical reflections. In what follows I will review these and other Keynes’s writings, in an attempt to shed some light into these contradictory analyses.

In *Economic Consequences of Peace*, written in 1919, Keynes admits that the *Laissez-faire* capitalism of the Nineteenth Century was an ‘extraordinary episode’ that was coming to an end. The conditions for that episode were population growth, access to raw materials at low prices, international mobility of capital and social conventions favouring saving and accumulation (Keynes,1919/2015). There is no specific reference to stagnation but a clear suggestion that the conditions that allowed for the great accumulation in the NINETEENTH Century were unrepeatable. The same idea is

rephrased one year later, in the review of Hawtrey's *Currency and Credit* (Keynes, 1920) and, in 1922, in 'An Economist's View on Population', where Keynes (1922/1977) suggests that society should be prepared to return to a phase of quantitative stability. Again, in 1922, in 'Return to Gold and Industrial Policy' (1922/1981), Keynes considers the possibility that the prevailing unemployment was not merely frictional but the outcome of underlying structural factors. In 'Am I a Liberal'? (1931/2015) that idea is reinforced.

The 1925 Moscow Lecture 'The Economic Transition in England' (Keynes, 1925/1981) develops the argument further. The NINETEENTH Century was a period of high flexibility and adjustment – the principle of diffusion – which gave place to some stabilisation/rigidity. This was the result of three main forces: i) progress; ii) trade unions' strength; iii) rise in humanitarianism, which protects people from the economic system. Institutional constraints played a role in imposing more rigidity on the economy, but the root causes of the situation had a structural nature. The general crescendo in the English economy during the NINETEENTH century had ineluctably come to an end.

In 'End of Laissez Faire' (1926/2015), this idea of structural change is lost.²³ Keynes admits that 'material progress between 1750 and 1850 came from individual initiative and owned almost nothing to the directive influence of organised society as a whole' (p. 43). He considers that the main evils of his days were ignorance and uncertainty and discusses techniques for improving capitalism through collective action aimed at directing savings and investment, mitigating ignorance through data dissemination and controlling currency and credit (Keynes, 1926/2015 p. 59). However, apart from a theoretical discussion on the fallacy of the *laissez-faire* doctrine (which may have made some sense in a certain historical period), there is no specific reference to a structural change in the economy and less so to diminished growth or stagnation. Keynes states that the assumption of unlimited opportunities for 'making money' is a crucial assumption in the *laissez-faire* theory but makes no further considerations on its validity.

Later, in January 1927, Keynes refers the psychological conditions that discouraged entrepreneurship and growth. He also assumes that the 'the picture of numerous small capitalists, each staking his fortune on his judgment, and the most judicious surviving, bears increasingly little relation to the facts'. The main argument was that it was possible

²³ This personal reading of the text is contrary to the interpretation proposed by Guthrie & Tarascio (1992).

for individual capitalists to increase production in a situation of permanent growth but, in the event of stagnation or even decline, some method of coordination would be necessary. More than ten years after *Economic Consequences of Peace* (1919/2015), Keynes's attention seems to have diverted from the long-term structural problems of capitalism and focus instead on the explanation and management of the cycle.

That was the purpose of *Treatise on Money* (1930/2015a). At this point, Keynes still thought that it was possible to influence investment by manipulating the interest rate. The book argues that the roots of the slump of the 1930s were the high level of the long-term interest rate, caused by: a slower increase in the population of industrial countries, better equipped than ever; the exhaustion of the need for war reparations; the return to the gold standard with a restrictive monetary policy; and, finally, the collapse in 'genuine borrowers', who were replaced by other type of borrowers, willing to pay higher interest rates — governments in distress, banks interested in building up liquid reserves and speculative borrowers:

'The divergence thus arising between the market rate of interest and the natural rate was, therefore, the primary cause of the sagging price level. But once this had proceeded far enough to generate 'slump' psychology in the minds of entrepreneurs, it was of course reinforced, as usual, by other and perhaps quantitatively greater influences.' (Keynes, 1930/2015a, p.148)

Each new cut in net investment will decrease prices further and impose new losses on entrepreneurs in business. 'But in the end a point comes – ... – when neither working capital or liquid capital are falling any further; and when this point is reached the slump touches the bottom' (p. 148). After this, one can expect a partial recovery, merely through the effect of compensating the previous destruction. However, a full recovery will need a considerable fall in the long-term interest rate.

It is therefore clear that although Keynes recognised some differences in the economic conditions of the post war period, the point of *Treatise* was to provide a monetary theory of the cycle.

The break with previous pessimism concerning the structural capacity of the capitalist system to provide growth and employment is even more obvious in the analysis of 'The Great Slump of 1930'. Keynes begins this essay on the Great Depression of the 1930s by asking:

‘Is he [the man in the street] now awakening from a pleasant dream to face the darkness of the facts? Or dropping off into a nightmare which will pass away? He need not be doubtful. The other was *not* a dream. This is a nightmare, which will pass away with the morning. For the resources of nature and men’s devices are just as fertile and productive as they were.’ (Keynes, 1930/2015b, p.153)

The real cause for the lack of investment is a feeling of distrust, by lenders and borrowers alike, combined with the exhaustion of investment opportunities related to the post war reconstruction. Recovery can only be guaranteed if lenders and borrowers are brought together. ‘Only if we seek a solution, will the optimism of my opening sentences be confirmed – a least for the near future’ (p. 157). And the solution would be for the central banks of leading creditor nations to join together in a plan to restore confidence in the long-term loan market.

Still in the 1930s, ‘The Economic Possibilities of our Grandchildren’ seemed favourable to Keynes, who persisted in rejecting the previous pessimism:

‘It is common to hear people say that the epoch of enormous economic progress which characterised the nineteenth century is over ... that a decline in prosperity is more likely than an improvement in the decade which lies ahead of us. I believe that this is widely mistaken interpretation ... We are suffering ... from the growing-pains of over-rapid changes, from the painfulness of readjustments between one economic period and another’ (Keynes, 1930/2015c, p.77).

The rapid progress in the Century was responsible for a temporary surge of technological unemployment. The world could expect greater progress in rising living standards.

The discussion on the conditions for recovery and the role of the long-term interest rate as a crucial element to bring saving and investment back on track continues through the 1930s.

‘An Economic Analysis of Unemployment’ (Keynes, 1931/2015) links the problem of unemployment to economic recovery, which depends on investment. Once again, two factors determine the latter: a fall in the long-term interest rate, and the return of confidence to the credit market:

‘But the central idea I wish to leave with you is the vital necessity for a society, living on the phase in which we are living today, to bring down the long-term rate of interest at a pace appropriate to the underlying facts ... But the worst of these developments [previous accumulation of capital and labour-saving innovations] is that they bring us to what may be called the

dilemma of a rich country, namely, that they make it more and more difficult to find an outlet for our savings. Thus we need to pay conscious attention to the long-term rate of interest for the fear that our vast resources may be running to waste through a failure to direct our savings into constructive uses and that this running to waste may interfere with the beneficent operation of compound interest which should, if everything was proceeding smoothly in a well-governed society, lead us within a few generations to the complete abolition of oppressive economic want.’ (p.166)

In a letter to the *New York Times* in 1934, Keynes reassures that the recession is cyclical and the result of lack of confidence. It is also in this period that the call for a better management of demand emerges as part of the argument. The reference appears in 1931, in ‘Saving and Spending’, where Keynes (1931) admits the severity of the slump but exhorts the animal spirits to bring back economic activity through increased spending. And, again, in a letter to Henry Wallace, written in 1935, the main argument is that underemployment can be a chronic problem if the lack of aggregate demand is not solved in the short term (CWK, XXI, pp.352-354).

General Theory (2008/1936) builds upon some of these ideas but it also breaks with previous arguments, namely, the view on the role of the natural interest rate as the element capable of assuring macroeconomic equilibrium. There are two main interpretations of the *General Theory*.

Firstly, there is what Joan Robinson called the ‘bastard Keynesianism’, the ideas proposed by Hicks and his followers of a new synthesis. According to this view, an underemployment equilibrium could arise in special occasions, in the presence of sticky prices (which keep real wages from adjusting) and liquidity preference (which keeps the interest rate from falling to match the marginal efficiency of capital). This view developed into the new neoclassical synthesis, which, as argued in the previous sections, is poorly designed to analyse and understand the problem of secular stagnation.

The second interpretation of Keynes’ *General Theory*, originally proposed by Joan Robinson, considers that underemployment could be the rule and not the exception in a capitalist economy with irreducible uncertainty:

‘Faced with irreducible uncertainty, hoarding is more rational than investing. Therefore, it is only ‘in moments of excitement’ that the private investment machine fully utilizes available human and technical resources to bring about improvements in welfare ... In GT, Keynes claimed that an unregulated

market, because of its stagnationist tendencies, kept resources scarcer than they would otherwise be.’ (Skidelsky, 2015, p. 183)

This interpretation seems consistent with some of the *General Theory* crucial points. First, Keynes makes clear that, in his view, the MEC (Marginal Efficiency of Capital) and its movements determine the cycle, sometimes even regardless the level of interest rates:

‘I suggest that a more typical, and often the predominant, explanation of the crisis is, not primarily a rise in the rate of interest, but a sudden collapse in the marginal efficiency of capital ... Later on, a decline in the rate of interest will be a great aid to recovery and, probably, a necessary condition of it. But, for the moment, the collapse in the marginal efficiency of capital may be so complete that no practicable reduction in the rate of interest will be enough. ... [I]t is not so easy to revive the marginal efficiency of capital, determined, as it is, by the uncontrollable and disobedient psychology of the business world. It is the return of confidence, to speak in ordinary language, which is so insusceptible to control in an economy of individualistic capitalism.’ (Keynes 1936/2008, p.196)

Secondly, Keynes admitted that the underlying forces that determine the schedule of the marginal efficiency of capital have changed since the NINETEENTH Century:

‘During the Nineteenth Century, the growth of population and of invention, the opening-up of new lands, the state of confidence and the frequency of war over the average of (say) each decade seem to have been sufficient, taken in conjunction with the propensity to consume, to establish a schedule of the marginal efficiency of capital which allowed a reasonably satisfactory average level of employment to be compatible with a rate of interest high enough to be psychologically acceptable to wealth-owners ... To-day and presumably for the future the schedule of the marginal efficiency of capital is, for a variety of reasons, much lower than it was in the nineteenth century. The acuteness and the peculiarity of our contemporary problem arises, therefore, out of the possibility that the average rate of interest which will allow a reasonable average level of employment is one so unacceptable to wealth-owners that it cannot be readily established merely by manipulating the quantity of money’.
(p.193)

Thirdly, Keynes psychological law suggests that rich economies will face difficulties in finding outlets for the excess saving:

‘This analysis supplies us with an explanation of the paradox of poverty in the midst of plenty ... Moreover the richer the community, the wider will tend to be the gap between its actual and its potential production; and therefore the more obvious and outrageous the defects of the economic system ... If in a

potentially wealthy community the inducement to invest is weak, then, in spite of its potential wealth, the working of the principle of effective demand will compel it to reduce its actual output, until, in spite of its potential wealth, it has become so poor that its surplus over its consumption is sufficiently diminished to correspond to the weakness of the inducement to invest. But worse still. Not only is the marginal propensity to consume weaker in a wealthy community, but, owing to its accumulation of capital being already larger, the opportunities for further investment are less attractive unless the rate of interest falls at a sufficiently rapid rate.’ (Keynes, 1936/2008, pp.26-27)

Therefore, although there is no explicit reference to secular stagnation, there is ground to support some of Keynes’s interpreters, such as Skidelsky, who argue that the *General Theory* contained a view of the stagnationist tendencies of the modern economies.

In 1937, Keynes writes that which is probably his most quoted work in the debate on secular stagnation. The Eugenics Review Lecture (1937b) has the reputation of having anticipated some of Hansen’s arguments in his theory of secular stagnation. Nevertheless, Hansen’s paper in 1934, mentioning stagnation as the decline of investment opportunities, proves that he preceded Keynes on that idea. The central point is the claim that population growth is essential for market expansion, as well as to create investment opportunities and confidence. Without it – like Keynes believed was the case at the time – the ageing of the existing population would cause higher levels of saving and less demand (investment and consumption). Without appropriate responses – increased consumption by means of a redistributive policy and lower interest rate – full employment may not be achieved.

The last reference, the ‘Long-term Problem of Full Employment’ (1943/2015) confirms the idea that capitalism will not provide the necessary answers to the problem of economic growth and unemployment. Therefore, the right policy mix is required if those goals are to be achieved.

There is no intention here to discuss the details, contradictions and complexity of Keynes’s economic thought. It seems clear that Keynes did not develop a concrete theory of secular stagnation; and that he even allowed himself some degree of confusion between long-term secular tendencies and short-term cyclical effects. However, Keynes was, from an early stage, well aware of the structural changes undergoing in mature capitalist countries. In the 1920s his work covered most of the social and institutional factors found in Hansen’s theory of stagnation. In the 1930s, Keynes analysis was mostly focused on

the monetary aspects of the cycle, and on the healing power of the interest rate. After that, the analysis became more ‘refined’, towards a more complete theory of investment based on the MEC.

From General Theory onwards, underemployment is no longer considered an exception but rather the normal outcome of an economy incapable of generating and directing investment flows into productive areas. Keynes explicitly outlines a theory in which richer countries’ saving habits – in face of the tendency of MEC to decline and the difficulty of bringing down the long-term interest rate – would prevent the output from reaching its potential. This is the main reason why, for some Keynesians, Keynes’s psychological law is the origin of modern stagnation theories (Smith, 1949).

The secular tendency for a decline in the MEC constitutes the central element in an otherwise very incomplete theory of the long-term development of capitalism.²⁴ The marginal efficiency of capital is defined as ‘being equal to that rate of discount which would make the present value of the series of annuities given by the returns expected from the capital-asset during its life just equal to its supply price’ (1936/2008, p.88). The production of an additional unit will be carried insofar as this rate exceeds the rate of interest, that is, as long as the return from creating a new capital fixed asset exceeds the advantages of using the same money in a different way (by lending it or buying an existing asset). If we change the terms of the equation, we get that the supply price equals the (annualised) prospective yields discounted by the MEC.²⁵ If one considers S to be the outlay or investment expenditure, q_i as the sum of the expected future revenues net of variable costs, and ρ as the rate that brings both together, or the MEC, the expression would be:

$$S = \rho \quad (8)$$

The market value of an investment, or its demand price, is thus given by the sum of the prospective yields discounted at the market rate of interest. In sum, the lesser the interest rate, the greater the demand price. As the latter grows, the number of projects for which the demand price exceeds the supply price will also grow (which means that the MEC

²⁴ The practical meaning of Keynes’s idea does not differ much from the well known theory of the falling rate of profit, already present in the works of Adam Smith, Karl Marx, David Ricardo or Stuart Mill. While Ricardo and Mill associated it to the tendency for exhaustion of natural resources, Adam Smith, connected it to the abundance of capital in modern societies. As for Marx, the law of the declining rate of profit is associated with the inner functioning of capital itself.

²⁵ Keynes defined the MEC as the element that equals the supply price and the expected returns of an asset, so that, for example, if a set of projects have the same prospective yields but increasing supply prices, the marginal efficiency of each project should be descendent. In the same way, with descendent prospective yields but equal supply prices, the rate of return should also be descendent.

exceeds the market interest rate), and new investment will take place.

Both the interest rate and the MEC participate in the same process but are independently determined. The interest rate is the result of prevailing liquidity preferences and the existing quantity of money. It is, according to Keynes, a rather ‘sticky’ variable, with limited impact on investment. On the other hand, the marginal efficiency of capital depends on the costs of replacing capital and on prospective yields, which are highly unstable, especially in the long term. Fluctuations in the MEC are thus one of the main determinants of the business cycle.

Two further considerations should be added to this short summary of Keynes’s theory of the marginal efficiency of capital. The first concerns the impact of financial markets on the inducement to invest, and the second its long-term interpretation.

The mere trade of stocks and securities is a balance sheet operation with no impact in terms of real investment. However, Keynes considered that the stock prices at any moment determined the inducement to invest. The higher the market price of a particular stock, the higher the marginal efficiency of capital in that sector in relation to the existing interest rate. Since the marginal efficiency varies according to the expectations on future yields, which are, in turn, the outcome of speculative decisions, financial markets contribute decisively to the precarious nature of the investment cycle. All innovations that enhance financial market activity and contribute to separate management from ownership tend to aggravate this process.

In the long run, one can expect that these cyclical variations will occur around a declining MEC, as prospective yields fall with the increasing accumulation of capital assets in the economy. As long as these rates are still higher than the market interest rate, investment will continue albeit at a slower pace. However, once the interest rate reaches a zero bound, there will be no impediment to capital asset creation and the abundance of capital assets will pull the marginal efficiency to zero.²⁶ This tendency might be offset by the type of special conditions observed in the Nineteenth Century, but not eliminated.

²⁶ Keynes believed that in the long run, as the MEC tends to zero, the mere ownership of capital assets would stop rendering an income. This ‘euthanasia of the rentier’ would have to occur with a previous fall in the interest rate, otherwise wealth owners would prefer to invest in buying debts instead of capital assets.

3.5. Kalecki's theory of investment: going where Keynes did not

Kalecki reviewed Keynes's *General Theory* in 1936 but its translation to English was published in 1982 only (Targetti & Kinda-Hass, 1982). The review identifies two blocks in Keynes' book. One is dedicated to the determination of short-term equilibrium, with a given level of investment and a known production apparatus. The second focuses on long-term determination of the volume of investment. While the first deserved Kalecki's recognition (he had reached similar conclusions albeit in a different way), the second was more problematic:

‘It seems that the first problem [the determination of short period equilibrium] has been solved in Keynes' theory very satisfactorily ... The matter is quite different as far as the second fundamental problem is concerned, namely, the analysis of the factors determining the level of investment. It is not only the exposition, but the construction itself, that reveals serious deficiencies, so that the problem remains, as we shall see, at least partially unsolved.’ (Kalecki in Targetti & Kinda-Hass, 1982)

One of the main deficiencies pointed by Kalecki, but also by Robinson (1962), in Keynes's long-term investment theory was its central concept, the marginal efficiency of capital (MEC). As explained above, Keynes defined MEC as the rate that balances the expected net revenues of a project with its supply price. In Keynes's long-term theory, the higher the rate of planned investment, the lower the MEC. He provides two reasons for this: first, given a determined level of installed capacity, the marginal cost will increase with the production of capital goods, due to the upward pressure on money wages and diminishing returns to factors of production; the second is that current investments increase future installed capacity, diminishing the expected returns of future profits.

Recall the expression presented above in equation 8. In Keynes's theory, an increase in investment expenditures in the short term would rise S and require lower levels of ρ , until the moment when ρ will equal the money rate of interest. After that point, there will be no incentive to invest. In the same fashion, an increase in today's investment will lower q_i , requiring future ρ to decline. These are Keynes's arguments for a declining MEC and subsequent declining rate of investment in the long term.

Harcourt (2006) introduces Kalecki and Robinson's critiques to Keynes's theory of investment by questioning the rational expectations assumption present in mechanics of his argument. Firstly, the equilibrium condition of $\rho = r$ requires investors to use future equilibrium prices of capital goods in their current calculations of expected profits. The

same reasoning underlies the assumption that present investment will increase future supply in face of a constant demand schedule, causing prices to decline (lower q_i). Considering, as Keynes did, that present experiences are the best forecast for an unforeseeable future, it is difficult to understand how an increase in the supply of capital goods will not imply higher expected long-term demand as well.

Unlike Keynes, Kalecki rejected a static view of investment dynamics, whereupon investment is affected by expectations without changing those expectations in turn. Alternatively, he distinguished between *ex ante* and *ex post* facts in relation to investment decisions. The marginal efficiency of capital is an *ex ante* determinant of investment, whereas prices are the *ex post* result of investment. Following this line of thought, if profits are determined by past investment (as Keynes and Kalecki believed), and if MEC represents the rate of discount of expected profits, then the increase in investment will not lead to a decrease in MEC. The conclusion is that there is no point of equilibrium for investment, and its behaviour in the long term is determined by a chain of short-term changes in economic activity.

Kalecki put together, instead, a theory in which the rate of investment depends, not on rational expectations on future prices, but on the financial conditions faced by firms, the existing stock of capital and prospects of future profits. Another distinction in relation to Keynes's theory is the denial of an environment of perfect competition, which is replaced by a world where power takes the stage. Kalecki's considerations on power included the introduction of concepts such as market power, referring to the capacity of large, oligopolistic firms to determine markups and, as a consequence, the functional distribution of income; workers' power, meaning the bargaining possibilities for workers to influence their share in the distribution process; but, also, capital's political power, as a class, to influence the policies in place.

Next, I will focus on a more technical application of the concept of power in Kalecki's theory. At the heart of his theory is the idea that it is investment, and not consumption, that determines the realisation of profits, which are distributed differently among firms, depending on their power to set prices. This capacity to set prices over costs is the measure of a company's degree of market power (degree of monopoly/oligopoly). Given the existing balance of power between workers and capitalists, the chosen margin of prices over costs will determine wages and profits and, consequently, the distribution of income between both. Since investment decisions depend greatly on profits, firms with market

and financial power will carry on the investment that determines aggregate demand and economic fluctuations.²⁷ Kalecki's ideas on oligopoly and investment decisions were the foundation for later theories of stagnation, like Steindl's, and deserve attention.

Kalecki saw society divided between capitalists (rentiers and entrepreneurs) and workers. Workers live off their wage, which, in Kalecki's model, is totally spent in consumption goods. Capitalists spend part of their income, composed exclusively by profits, on capitalist consumption goods and save the rest to spend in investment goods (accumulation of fixed capital). The sum of gross investment (I), capitalists' (C_c) and workers' (C_w) consumption, plus State spending (G) gives us the gross national income (GNI), that should equal the sum of associated expenditures: profits (P), wages (W) and taxes (T):

$$\text{GNI} = I + C_c + C_w + G = W + P + T \quad (9)$$

If workers spend all their income on consumption, C_w = W. If we then subtract government expenditures from taxes, we will get the fiscal deficit. Making the correspondent substitutions in the above equations, the result will be Kalecki's profit equation:

$$P = I + C_c + (G - T) \quad (10)$$

If workers were allowed to save, their saving (W - C_w) would have to be subtracted from the right-hand side of the equation, in the same way that the trade surplus would be added if the assumption of a closed economy was dropped.

The profits equation is an identity derived from national accounts, with no implied causality. However, Kalecki then notes that capitalists can decide what they will spend in each period on consumption or investment, but not what the future income associated with that spending (profits) will be. Assuming a stable propensity to consume by capitalists will balance workers' saving and considering that the fiscal deficit represents a small part of the GDP, investment decisions are the main determinant of profits.²⁸ This

²⁷ See Kalecki (1935, 1968) for more on the relation between investment and the business cycle.

²⁸ The process is similar to the Keynesian multiplier. Kalecki (1939/2003) divides the economy into three departments: investment goods (I gds), capitalist consumption goods (C_c gds) and workers consumption goods (C_w gds). The C_c gds department pays out the wages of their workers which come back as income, plus the income associated to workers' consumption in other departments. Their profit is then equal to the amount of wages paid in other departments. The profit in the other departments (I gds and C_c gds) equals their income less the cost of paying wages. But that cost, as we have seen, is in fact the profit of the C_w gds department. In order to obtain the total profits of the economy, one can add up the individual profits of each department, or simply sum up the output (income) of the I gds and C_c gds departments. Using this method, expenditures in investment and capitalist's consumption goods will still equal the amount of profits. If, for some reason, there is an improvement in capitalists' expectations, production and employment in the I gds department will increase. As a result, workers will consume more, leading to more employment and output in the C_w gds dep. With higher investment and production, capitalists will also consume more, causing new positive spillover effects in the remaining sectors.

means that aggregate investment and consumption decisions by capitalists determine their profits as a class (Kalecki, 1942). It also means that, collectively, it is investment spending that generates the profits that can be saved or used to repay bank credits and that, as an aggregate, investment is not constrained by saving in the economy. In the words of Kalecki:

‘Capitalist expenditure “forces” an income equal to the amount of this expenditure. Because this expenditure is formed by consumption and investment, and income is formed by consumption and savings, we can also say that investment “forces” savings whose value is equal to the same value of this investment. Generally, the capitalists who invest are not the same ones who save. The investment of the former creates equal savings of the latter.’ (Kalecki in Targetti & Kinda-Hass, 1982, p.249)

Individually, the amount of a firm’s internal funds accumulated out of profits can limit investment, mostly in the case of small and medium enterprises. When it comes to large corporations, the use of external finance mitigates this restriction but increases financial risk.

At firm level, profits exist on a persistent basis because each department considered by Kalecki (workers’ consumption goods, investment goods, capitalists’ consumption goods) has multiple industries characterised by a certain level of oligopoly power (determined by market imperfections such as transportation costs, consumer sensitivity to price differences and product differentiation, but also by the extent of collusion and the specific history of each industry).²⁹

Each production unit faces direct costs (materials and labour) and overhead costs (selling costs, depreciation, interests, and so on). Kalecki argued that up to full capacity average direct costs (and marginal costs) were constant, while overhead costs declined with increasing levels of capacity utilisation. Given its degree of oligopoly, each firm establishes its price above (marginal) direct costs, so to cover overhead costs and profits, which constitute the gross profit margin (GPM).³⁰ This means that the share of profits in sales, such as the share of profits in national income, depends on the oligopoly power of each firm.³¹

²⁹ In his work on Cartels, while in Poland, Kalecki concluded that most industries operated below full capacity. His ideas on monopoly power evolved so that he explicitly assumed that perfect competition did not exist in the economy. In 1938, he publishes *The Determinants of Distribution of National Income* in *Econometrica*, where he points out that monopoly is the ‘normal case’ in capitalism and explores its consequences in the distribution of income.

³⁰ Kalecki argued for a secular increase in the degree of monopoly.

³¹ Usually referred to as *degree of monopoly*, it can be defined as the difference between price level and marginal cost, divided by the price level.

Besides prices, firms also decide the level of investment to undertake. Investment decisions are based on the expected rate of profit of each project (in comparison with the interest rate plus a risk premium) and respect an endogenous limit, the principle of increasing risk (Kalecki, 1937).

The idea derives from the understanding that investment must be financed, and that financing through internal funds or external borrowing is not equivalent in terms of costs or risk. Internal funds depend ultimately on the accumulation of profits from past investment and therefore depend on the capacity of a given firm to invest. Apart from previous profits, the greater the size of a firm's own capital the greater its capacity to obtain borrowed money at a better price. Moreover, the risk of an excessive debt burden increases with the proportion of borrowed money in relation to the size of the firm. Kalecki main argument is that 'the size of the firm thus appears to be circumscribed by the amount of its entrepreneurial capital both through its influence on the capacity to borrow capital and through its effect on the degree of risk' (Kalecki, 1971, p. 106).³²

Returning to one of the initial ideas outlined in this section, for Kalecki, the level and rate of investment does not depend, as in Keynes, on expectations of future prices or costs, compounded in an ever-declining rate of marginal efficiency of capital. The present conditions faced by actual firms determine investment. This, according to Sawyer (1985) and to Targetti & Kinda-Hass (1982) constitutes a meaningful difference between Keynes's and Kalecki's theories of investment.

Finally, we can move to the determination of income and its distribution. Kalecki was particularly concerned about the impacts of a change in the degree of oligopoly in the distribution of income and employment. He predicted that the degree of oligopoly had a procyclical nature: during a recession, less enterprises would attempt to enter the industry, while the remaining ones would maintain prices despite the decrease in average costs, negatively affecting the level of economic activity. In the case of a boom, oligopolists would tend to over-invest in order to secure a larger share of controlled market. Real wages would vary according to the firms' capacity to maintain price-profit margins across the business cycle but would never determine those margins.³³

³² Recall that Kalecki views Money as endogenous, which means that the Money stock is ultimately determined by firms' demand for loans.

³³ Real wages are then determined by the encounter of money wages (the result of workers' power) and prices (the result of firms' market power).

Summing up, Kalecki's contribution to the stagnation theories developed by Steindl and, later, by Sweezy, is based on the idea, advanced by Luxemburg, that surplus must be realised. The realisation of surplus does not depend mainly on workers' consumption — as suggested by Marxist underconsumptionist views, also present in earlier works of Sweezy (1942) — but on capitalist's expenditures in consumption and investment. The degree of monopoly interferes with the distribution of profits, concentrating the surplus in companies not willing to invest. It therefore affects the overall levels of investment, as well as the total share of profits in net output.

3.6. Steindl's response to Kalecki's challenge

Steindl's stagnation theory is a theoretical extension of Kalecki's theory of investment. The context of its appearance was explained by Steindl himself:

‘On one occasion I talked to Kalecki about the crisis of capitalism. We both, as well as most socialists, took it for granted that capitalism was threatened by a crisis of existence, and we regarded the stagnation of the 1930s as a symptom of such a major crisis. But Kalecki found the reasons, given by Marx, why such a crisis should develop, unconvincing: at the same time he did not have an explanation of his own. I still do not know, he said, why there should be a crisis of capitalism, and he added: Could it have anything to do with monopoly? He subsequently suggested to me and the institute, before he left England, that I should work on this problem. It was a very Marxian problem, but my methods of dealing with it were Kaleckian.’ (Steindl, 1985)

Steindl accepted the intellectual challenge posed by Kalecki and developed a long-term theory of growth based on Kalecki investment theory and its main elements: relative indebtedness, past savings and degree of capacity utilisation. The result was published in 1952 under the title *Maturity and Stagnation in American Capitalism*. In it, Steindl offers an endogenous explanation of the economic trend based on the premise that the accumulation of business savings (internal accumulation) induces investment that generates future savings, so that, in practise, investment generates investment: ‘The most important feature of this explanation of the trend is that it is an *endogenous* theory. It starts from the conviction that in order to explain the historical phenomenon of growth of capital it is not necessary to have recourse to external influences, such as innovations, population growth, wars, etc.’ (Steindl, 1952/1976, p.192)

The book opens with a discussion on what determines the firms' excess capacity, and its impact on investment decisions. Steindl then analyses the patterns of competition within industries and the processes under which oligopoly is formed. There are two distinct situations: a competitive industry (with several small producers) and an industry difficult to enter (oligopoly).

In the first type of industry, there are several firms with different sizes and hence, due to economies of scale, different profit margins. The group formed by the lowest size firms is subject to normal profits and faces the fierce competition of new entrants. The group of larger firms, which obtains more than normal profits and is more likely to develop cost-reducing techniques, faces better conditions to expand relatively to the group of small firms. If the industry, as a whole, expands at least as fast as the group of progressive firms³⁴, then the share of small firms in the industry can be kept. If the opposite happens, the latter will lose part of their share of the market to the former. This additional share of the market can only be captured if progressive firms engage in some kind of sales effort³⁵ and hence reduce their profit margin in an amount equivalent to a part of the initial advantage provided by the initial innovations. There is a special case in which the internal accumulation of large firms surpasses a certain limit and their expansion can only happen at the expense of the existence of other (small) firms. It is a long-term and permanent process of absolute concentration, because the new higher markups will prevent the previous firms from re-entering the market.

This process of absolute concentration will come to an end when the sales effort carried out by progressive firms causes a decline in the industry profit margins. This decline will bring the rate of internal accumulation back to a level consistent with the industry rate of expansion.

‘The conclusion is then that the rate of internal accumulation and consequently the net profit margin at given levels of capacity utilisation will *tend* to a (maximum) level determined by the rate of growth of the industry, the rate of capital intensification, and the rate at which existing capacity is being eliminated.’³⁶ (p.51)

³⁴ ‘Firms which initiate new methods’ (Steindl, 1952/1976, p.45).

³⁵ Sell at lower prices, engage in quality competition or invest in advertisement.

³⁶ ‘Capital intensification proved an outlet of funds in the industry, just like the expansion of the industry does’ (Steindl, 1952/1976, p. 48).

In other words, the accumulation of internal funds generates a competitive pressure that imposes limits on the share of profits for the product and brings about processes of absolute concentration.

In the second type of industry, even the marginal firms have abnormal profits, which make them more resistant to any attempt by the progressive firms to throw them out of the market. For a price war to be effective, progressive firms will have to cut prices by an amount that exceeds marginal firms' net profit margin at a given level of capacity utilisation. Since this strategy would probably offset any partial gains coming from cost cut innovations, it is not likely that progressive firms will choose it. In oligopolistic industries, 'the internal accumulation therefore tends to exceed the amount required for expansion of capital equipment in these industries. The flow of the "surplus" funds into other industries is impeded by the additional effort required for entering new lines which weakens the incentive to invest for the owners of these funds.' (p. 55)

Chapter IX extends the analysis outlined above to the economy as a whole. Investment is presented as a function of the internal accumulation of the firm, the degree of utilisation of capacity, the gearing ratio (relative indebtedness) and the rate of profit. The rate of growth of capital affects these factors in a transversal way. For example, if there is a decline in the rate of growth of capital, internal accumulation will be reduced as a consequence of a reduction in the rate of profit. If competitive industries prevail, the adjustment that allows the profit rate to fall will take place without a reduction in the degree of capacity utilisation (competition through prices and elimination of marginal firms). However, in the case of mostly oligopolistic industries, there is no mechanism to bring the rate of profit down, and the result will be a decline in the degree of capacity utilisation, that does not come without a fall in national income and employment. Unemployment weakens effective demand, increasing the excess capacity even more and forcing new cut backs in investment. The effects of this further reduction in effective demand will be felt in both types of industries – competitive and oligopolistic. However, while in the former the result will be a reduction in the profit rate,³⁷ in the latter utilisation will be reduced so to maintain the rate of profit.

³⁷ This process of falling rates of profit is worsened by the effect that unexpected declines in the rate of internal accumulation have on the gearing ratio of firms, especially the most fragile. The argument is presented in the following way: 'Assuming that outsider savings are relatively inelastic, the further drop in the accumulation of real capital will not be accompanied by a corresponding drop in the accumulation of outsider savings, and consequently internal accumulation must drop more than total capital accumulation, and the entrepreneurs will find that their relative indebtedness (gearing ratio) continues to grow' (Steindl, 1952/1976, p.114).

The result will be a shift in profits from the competitive to the oligopolistic sector. The investment lost in the first sector will not be compensated by new investment in the second, causing total investment to decline. 'The conclusion is that the maldistribution of profits and internal savings consequent on the growth of oligopoly will have a depressing effect on the rate of real capital accumulation' (p.127).

Steindl also tries to address the impact of the development of the joint stock system on the trend of capital accumulation. He mentions two contradictory effects. First, the stock market makes it possible to supplement internal savings (accumulation) by issuing new shares. Still this positive impact on investment may be offset by the distribution of dividends and high wages which increase outside savings. There was a period when the first effect prevailed, counteracting the tendency of the rate of profit and of capital growth to decline. However, that effect was exhausted.

Finally, other types of accumulation, besides private business investment (budget deficits, residential house building and foreign investment), are considered. In this case, a fall in business accumulation can be compensated by borrowing in other sectors, so as to avoid an excess of outside savings in relation to the degree of accumulation. Steindl argues that this compensatory borrowing will be able to prevent the ratio of total saving to business capital rising, and therefore, to avoid an increased gearing ratio. However, it cannot stop the profit rate from falling. Non-business capital (or debt capital) grew as a consequence of the decline in business accumulation and rise of compensatory borrowing due to war efforts, to the rise in consumers' debt and a deficit financed by governments during the Great Depression.

In the introduction to the *Monthly Review* reprint of *Maturity and Stagnation*, written in 1976, Steindl adds a third argument and changes a structural assumption. The argument no longer 'depend[s] on oligopoly, but on the growth of big business generally. It says that the preference for safety increases with size, and that profit is bartered for safety, with resulting reluctance to go into debt and a consequent weakening of the incentive to invest' (p.xv). The structural assumption dropped concerns the role of technological developments on accumulation.

3.7. The Monthly Review theory

The finance-monopoly capital theory provides an explanation for stagnation in modern economies based on the very contradictions of capitalism. In short,

‘[It] is a theory which, stripped to its barest essentials, sees the mature monopoly capitalist economy as one that is subject to, and indeed dominated by, a basic contradiction: the very growth of its productive potential puts insuperable obstacles in the way of making full use of available human and material resources for the satisfaction of the needs of the great mass of the population. What this means is (1) that in the absence of sufficiently powerful counteracting forces, the normal state of the economy is stagnation; and (2) that the real history of the system in its monopoly capitalist phase is determined by the interaction of the tendency to stagnation and the forces acting counter to this tendency.’ (Sweezy & Magdoff, 1987, p.23)

In the words of Kalecki,

‘the tragedy of investment is that it causes crisis because it is useful. Doubtless many people will consider this theory paradoxical. But it is not the theory which is paradoxical, but its subject - the capitalist economy.’ (Kalecki, 1939/2003, p.149)

According to the Marxist reproduction scheme, the surplus generated will only find enough investment outlets if the department of means of production is growing faster than the department of consumer goods. As the stock of capital builds up, the previous condition is less likely to occur, and every new cut in investment or increase in the rate of overexploitation of the working class will only aggravate the problem. Demand will not be enough to realise the surplus value, i.e., to buy back all the potential output.

Nonetheless, the system has found new forms to offset this constant tendency to stagnation, which Baran and Sweezy denominate waste, a concept that resembles Veblen’s idea of wasteful expenditure: marketing and all types of sales efforts; public spending, especially on defence; consumer debt and financial activities.

The poor treatment the financial sector received in *Monopoly Capital* (Baran & Sweezy, 1966) was compensated in a series of subsequent writings, mostly with the contribution of Harry Magdoff.³⁸ In the monopoly theory, finance became the most important form of systemic waste. It can have, it is recognised, a partial positive effect on production and employment, due to the wealth effect³⁹, but, in the long term, it will always be a

³⁸ Magdoff & Sweezy (1972), Sweezy & Magdoff (1983), and Sweezy & Magdoff (1987).

³⁹ Financial gains increase capitalist’s consumption and, therefore, the chances of surplus absorption.

destabilising force. Moreover, it will be the source of new contradictions, since the accumulation of financial gains is the source of bubbles which inevitably tend to burst. The concentration of financial wealth has also important aggravating effect in the already unequal distribution of income.

From the end of the Nineteenth Century onwards, with the development of large corporations, the issuance of several types of securities and the growth of stock markets, productive areas became more and more intertwined with the financial sphere, the latter rising proportionally more than the former. Contrary to common thinking,

‘there is no presumption, let alone assurance, that money invested in any of these instruments will find its way, directly or indirectly, into real capital formation. It may just as well remain in the form of money capital circulating around in the financial sector, fuelling the growth of financial markets which increasingly take on a life of their own.’ (Sweezy & Magdoff, 1987, p.97)

Non-financial corporations were a crucial part of this process:

‘Unable to find profitable productive investment opportunities in the face of excess capacity and flagging demand, they have been eager participants in the merger, takeover, and leveraged buyout frenzy that has swept the country in recent years, becoming in the process both lenders and borrowers on an enormous scale’ (p.17).

Hence, Magdoff and Sweezy criticise orthodox economics for its poor understanding of money and financial factors. It is not possible, as suggested by mainstream theories of the 1980s, to separate the economy into a real and monetary realm, so that money will not interfere with real production decisions. Instead, the distinction should be between productive base and financial superstructure. The argument is that the financial realm can expand while the productive one remains stagnant. In face of idle capacity and stagnant demand, excess money will most likely end up contributing to a process of price-asset inflation in financial markets.

It is possible now to relate Steindl and Kalecki’s theories of investment and stagnation to the contributions of Baran, Magdoff and Sweezy. Monopoly finance capital has the capacity to generate a great amount of profits⁴⁰ in relation to the investment opportunities, translated in excess saving and installed capacity.⁴¹ The production of waste can mask

⁴⁰ There is in fact a hierarchy of profit rates according to the size and relative power of each firm.

⁴¹ Since adjustments will not happen by means of price changes but rather by chosen levels of capacity utilisation.

the problem for a certain period, but it will not solve the inner contradictions of the system.

This is not to say that some sectors will not thrive and expand: ‘where vigorous markets exist ... money is available and investment is flourishing’ (Sweezy & Magdoff, 1987, p.58). However, the system will still be in a situation of excessive capacity in the manufacturing industries in general. Primarily because these new industries, such as cutting-edge electronics and communicating technologies, have minor effects in terms of manufacturing and have mostly helped to expand finance even further.

3.8. Some advances in Post-Keynesian and Kaleckian models

The literature on growth and distributional Post-Keynesian and Kaleckian models is vast and there is no attempt to cover it in this review.⁴² The point is to focus on the impacts of the development of finance on investment and growth theories. The introduction of finance implies the recognition that investment decisions are often influenced by financial motives.

Post-Keynesian/Kaleckian literature identifies two main channels: the crowding out effect and the internal means of finance. The crowding out argument states that, considering the limited funds available to a non-financial corporation, an increase in financial assets will lead, necessarily, to a decrease in non-financial forms of investment. This argument seems to capture a real trend in non-financial corporations towards financial investments. However, it relies on a loanable funds view when it relates the lack non-financial forms of investment to the limited funds available. From a conceptual point of view, such limitation does not exist in an economy with endogenous money. From a practical point of view, large corporations that engage in financial operations are not limited by the lack of funds.

The crowding out channel is based on the idea of Tobin (1965), who stated that since real and financial investment could be substitutes, capital would be channelled to those investment projects offering higher returns. However, although this substitution holds at micro level, on a macro scale financial transactions do not necessarily have a translation in terms of use of productive resources (Orhangazi, 2007).

⁴² See Hein (2014) for an overview of several models, Dutt (2015) for an example of a simple distribution model and Blecker (2010) for a summary of the main developments of post-Keynesian models in open economies with financial and trade flows.

As described by Tobin, managers' investment choices play an important role in this process. Their preference will be for increased financial returns in the short term, jeopardising long-term productive investment (Hein, 2009).⁴³ Crotty (2005) reasserts the idea that, from the 1980's, non-financial corporations have been dominated by a 'portfolio view' and adds the importance of financial subsidiaries to this process. He defines this portfolio view as one in which firms are simply managers of financial assets, which are bought or sold according to their short-term rate of return (Crotty, 2002). The increase of financial rents in detriment of productive accumulation in the non-financial sector is also pointed out by Krippner (2005). Stockhammer (2004) describes the process by which non-financial corporations start acting like financial market players.

The literature identifies several factors that contribute to this change in management preferences, turning away from productive investment. Most are connected to the concept of shareholder value. As mentioned by Crotty (1990), the growth of capital markets and the widespread use of shares and bonds made shareholders more concerned about the short-term market value and profitability than with their firm's expansion or long-term survival. During the 1980s and the 1990s, especially in the US, the hostile take-over movement has created new investment trends: the 'downsize and distribute' (Lazonick & O'Sullivan, 2000), characterised by a disinvestment in non-financial corporations in order to increase dividends and, therefore, market values; and the 'buy it, strip it, flip it', which consists on dismantling pre-existing companies, which are sold in parts and financed through debt in order to, once again, increase dividend payments. Payments in share options and similar rewards contributed to create an alignment between the interests of shareholders, mostly institutional investors, and managers' preferences.

These widespread pressures for managers of non-financial corporations to increase immediate market returns have shortened their planning horizons (Crotty, 2005), and created incentives towards investment in financial assets. This has favoured a rent seeking behaviour (Hein, 2009; Hein & Dodig, 2014) which, in turn, has contributed to raise instability in the non-financial sector (Orhangazi, 2008) and to crowd out real productive investments.

⁴³ The same process is identified by Binswanger (1999) for non-financial companies in the US.

In addition, Crotty (2008) and Orhangazi (2008) also argue that the increase in financial assets by non-financial corporations was a way to circumvent the decrease in profits in the real sector on the aftermath of the Fordist regime's decline.

The financial payments or internal means of finance argument (Hein, 2009) refers to the process of depletion of firms' available (internal) funds by increasing payments to financial markets through stock buy backs, dividends and interests (Orhangazi, 2008).

The main goal of stock buybacks and dividend payment is to increase the market (shareholder) stock prices. These operations are usually financed with retained profits, but also with new debt, increasing even further the future payments to financial actors (Aglietta & Breton, 2001). Besides reducing internal funds, which, according to Duménil & Levy (2004), is closely related to the rate of capital accumulation in the non-financial sector, this process also increases instability. Uncertainty relatively to the price of stock and bonds buy backs or to the level of future interests shortens the time horizon of firm managers and gives rise to a movement from patient to impatient finance (Orhangazi, 2007). Remuneration schemes reinforced the orientation of non-financial firms away from real investment and towards short-term capital gains. In short, managers adopt the same evaluation criteria as financial markets. If the latter undervalue long-term investment and gains, so will managers.

To sum up, 'increased financial payments to financial markets can constrain real investment by depleting internal funds, shortening planning horizons, and increasing uncertainty' (Orhangazi, 2007, p.16).

A related but less developed strand of literature focuses on corporate finance operations, to understand the intertwining between financial and bank markets and non-financial corporations.

Based on the evolution of corporate finance, Toporowski (2017) distinguishes between the financial crisis of classic capitalism and that of today's capitalism. In the classic case, non-financial firms used their own funds and short-term borrowing to finance long-term industrial assets. These debts will be rolled over, unless there is some distress in the banking sector, causing a serious liquidity problem to the firm sector. This type of crisis is now 'the standard financial crisis of mainstream economics and radical political economics: a combination of bank illiquidity, due to maturity transformation, and credit "crunch" as lending facilities are withdrawn due to that liquidity' (p.578).

However, nowadays the system works differently. The emergence of markets for long-term debt made financing easier but brought new preoccupations: firms now have to meet their increased financial obligations in terms of interest and dividends (as predicted in the financial payments channel) but also to ensure that the market for the assets they have issued is sufficiently liquid. 'Hence, companies are obliged to hold excess capital that is turned over in restructuring their financing' (Toporowski, 2016b, p.6). In order to meet this necessity, a new world of financial instruments was created, most of it based on short-term borrowing to finance long-term positions, often for speculative reasons. The changes operated in corporate and financial markets have also facilitated the concentration of capital or, in other words, the advent of oligopolies, as described by the Monthly Review theory. In fact, as argued by Toporowski, the emergence of monopolies in the Twentieth Century is not so much the result of natural monopolies or increasing returns to scale, but rather the outcome of the development of capital markets and, more recently, the need to manage financial resources.

In order to understand the role of corporate finance in the last financial crisis, Toporowski argues that a distinction must be made between large non-financial business corporations and small and medium enterprises (SMEs). Big corporations have access to financial markets and instruments to manage their financial structure. SMEs, on the other hand, are stuck with rather inflexible banking contracts. Large companies determine the cycle and aggregate demand. However, SMEs generate most of the employment in the private sector.

The main argument, which is useful to retain in the context of the discussion on stagnation, is that large companies got largely indebted to expand and generate financial profits. Eventually, these financial structures became unsuitable, and since raising equity or selling assets was not a viable option, their strategy, as a class, was to reduce fixed investment. Therefore, 'it is this decline in investment, rather than any fall in the consumption of indebted households ... that caused the so-called 'Great Recession' in Europe and North America' (Toporowski, 2016b, p.14)

Hein (2011) mentions three macroeconomic regimes that have emerged from these structural changes in the capitalist system: a finance-led growth, in which the short-term effects of financialisation on consumption (either capitalists' consumptions or workers' consumption via credit finance) and investment dominate; a profits without investment regime, in which there is an increase in profits from financial activities and increased

markups but it is insufficient to increase capital accumulation; finally, a contractive regime. In this case the shareholder value orientation impairs firm's capacity to invest, accumulate and profit.

Hein (2015) puts forward a model of Steindlian stagnation to argue that mature capitalist economies avoided stagnation in the 1950s due to:

- i. A rise in autonomous investment (α) caused by public spending based on taxes on profits;
- ii. Technological competition and advances coming from the United States in the context of the Cold War (ωy^{\wedge});
- iii. Institutions and regulations that, together with workers' bargaining power, helped to contain the rise in the profit share of income (h) and on markups (m).

The mid 1970s saw the resurgence of stagnation tendencies, as predicted by Steindl, motivated by several factors. To begin with, there was the collapse of those institutions created to manage capitalism (Bretton Woods) and the fading out of the catching up effect of several European economies after the war. Technological advances have increased capital productivity and lowered, consequently, the need for greater amounts of net investment. The household propensity to save has also increased, at the expense of demand and future capacity utilisation and growth. Nonetheless, Hein argues, in line with Kalecki, that the most important factor influencing stagnation is how the interests of corporations influenced policy. Restrictive monetary and fiscal policies have caused opposite movements in the main variables that were containing stagnation: autonomous investment was cut because of fiscal austerity and the profit share increased due to workers' losses in terms of bargaining power and higher financial payments from firms; households' propensity to save also increased as a response to uncertainty and inequality. Finally, the growing financial payments made it increasingly difficult for firms to accumulate internal funds to finance investment.

3.9. Empirical research on stagnation tendencies and market power

The main and most consolidated stagnation theories were reviewed in section 3.7. Contrary to other views that place the source of dismal investment and growth on exogenous factors – whether technological breakthroughs or demography –, these

theories focus on the endogenous nature of stagnant tendencies in capitalism.

In a broad sense, the idea they all share is that the essence of capitalism is the accumulation of capital, and that that process will necessarily come about with the concentration of formed capitals, either through competition, at the expense of smaller capitalists, or through collusion and cartelisation. In one way or another, such concentration will provide oligopolists with the power to appropriate larger proportions of total surplus, at the expense of economic stability and – without public spending programs or financial bubbles — investment and growth.

Only recently has the increase in market power attracted attention, mostly in the USA, as an explanation for the documented changes in most mature capitalist economies – lower average growth and investment, rising income inequality and unemployment, higher indebtedness levels.

De Loecker & Eeckhout (2017) use firm-level data for the US economy since the 1950s to show that market power, measured through markups, has increased from 1980 onwards. CEA (2016) also report that ‘many industries may be becoming more concentrated, that new firm entry is declining, and that some firms are generating returns that are greatly in excess of historical standards’ (p.14).

The reasons for increasing market power after the 1980s are placed within the changes in merger policy in the 1980s, namely after the introduction of the Rule of Reason (Peltzman, 2014; Khan & Vaheesan, 2016). Kulick (2017) and Blonigen & Pierce (2016) also associate the wave of mergers and acquisitions with increase in markups. Grullon, Larkin & Michaely (2014) show that the consolidation of publicly traded corporations increased concentration and that sectors with higher concentration levels also display higher markups, stock returns and market values.

Apart from concentration at the industry level, literature has also begun to focus on firm ownership concentration. At European level, Wigger & Buch-Hansen (2017) explain how the European Commission has legitimised a pro concentration stance and promoted a policy of consolidation of economic power in large transnational corporations. Azar, Schmalz & Tecu (2018) report that the increase in the concentration of ownership in the airlines sector raised average prices by 10%. Azar, Raina & Schmalz (2016) show that increases in bank ownership in the USA led to higher fees. Domanico (2007) argues that liberalisation created collusion and concentration risks in electricity markets in Europe.

Mammana (2014) describes the elevated concentration levels in the European market for seeds, reporting that, for example, only 5 companies control 75% of the market share of maize seeds and that 4 companies control 86% of the market share of sugar beet seeds. Increasing concentration levels across countries in the banking sector were also acknowledged in the Report on Financial Structures, published by the ECB in 2016 (ECB, 2016).

A related line of investigation concerns the increasing power of large asset management companies, that hold in their portfolio important stakes in big companies across the world, controlling larger shares of entire stock markets and economic sectors. Azar (2011) studies the impact of institutional investors portfolio diversification on market structure, arguing that, through shareholder voting, portfolio diversification generates tacit collusion. Fichtner, Heemskerk & Garcia-Bernardo (2017) found that the three largest asset management companies – Blackrock, Vanguard and State Street – are the largest shareholders of 88% of the companies listed in the S&P500 index.

Regardless of the methodology chosen to measure it, the increase in market power has been associated to a number of negative macroeconomic outcomes. Gonzalez & Mathy (2016) point the rise of monopoly rents as one of the causes for secular stagnation and find a connection between increasing markups and the rise of corporate profits, the slowdown of output and investment, and wage stagnation. The link between a decline in competition, market concentration and low investment has been mentioned by Autor et al. (2017), Midrigan, Philippon & Callum (2016), Gutiérrez & Phillipon (2016) and Lee, Shin & Stulz (2016). Autor et al (2016) use panel data from the US Economic Census since 1982 and find a negative correlation between industry concentration and declining labour GDP share, higher corporate profits and under-investment. Midrigan et al. (2016) argue that a secular decline in competition in goods markets ‘explains several macroeconomic puzzles’, namely low real interest rates and weak corporate investment. Gutiérrez & Phillipon (2016) show that, particularly after the 2000s, a decrease in competition weakened the link between a firm’s profitability and valuation, on one side, and investment on the other. They also show that firms in more concentrated industries spend higher shares of their cashflows on shareholder remuneration schemes, such as stock buybacks. Finally, Lee et al. (2016) find that since the mid 1990s capital funds stopped flowing to companies with best growth opportunities and started being directed to companies with more intensive remuneration schemes. They also report a negative

correlation between capital expenditures and market value of assets at the industry level. Related literature links the decline in investment to the increase in corporate payouts and share buybacks (Gruber & Kamin, 2015) and points out that the relation between borrowing, cashflows, and investment has been replaced with dividend distribution (Mason, 2015).

Inequality has also been identified as one of the most notorious outcomes of market concentration and markup increase. The phenomenon is usually addressed from two perspectives: unequal distribution of income between labour and capital, with the decline in the former compensated by an increase in the latter; and unequal distribution of income within labour and capital shares.

The decline in labour share, in the US (Elsby, Hobijn & Sahin, 2013) and worldwide (Karabarbounis & Neiman, 2013; Schweltnus, Kappeler & Pionnier, 2017), is attributed to several factors: globalisation and offshoring of part of the supply chain in the manufacturing sectors (Elsby et al., 2013); decline in workers' bargaining power (Bental & Demougin, 2010; Stiglitz, 2012); capital augmenting technological changes, mechanisation of production and decline of the relative price of investment goods (Jones, 2003; Karabarbounis & Neiman, 2013; Brynjolfsson & McAfee, 2016; Acemoglu & Restrepo, 2016). A subgroup of literature argues, following the typical neoclassical production models, that the decline in the labour share compared to the capital share is the efficient outcome of the substitution effect between capital and labour, as the price by capital drops. Fernald and Jones (2014) discuss how the replacement of workers for machines could lead to higher capital shares, lower labour shares and economic growth. Blanchard & Giavazzi (2002) state that the decrease in the bargaining power of workers in Europe since the mid 1980s led to real wage reduction and unemployment. These facts are presented as temporary outcomes of an adjustment process promoted by deregulation and, according to the proposed model, 'the future should be brighter', with higher levels of employment and output.

More critical approaches relate the decline in the proportion of income going to wages to the process of capital concentration and accumulation fostered by financialisation, responsible for increasing levels of inequality, economic instability, aggregate demand and growth. Gonzalez and Trivin (2017) use a panel of 41 countries to show that the decline in the labour share is associated to an increase in the market value of corporate assets (Tobin's q). Piketty (2014) and Piketty & Zucman (2014) argue that accumulation

and concentration of capital are driving aggregate saving relative to income, causing the capital stock to rise relatively to income and wages.

Barkai (2016) suggests that, because of declining competition and increasing markups, both labour and capital factor shares have been declining in the US. This decline ‘is accompanied by large gaps in output, wages, and investment and that without a subsequent increase in competition, the labor share will not revert to its previous level’ (p.5). Contrary to the neoclassical prediction, not only is the labour share declining, but capital expenditures in the non-financial sector are not increasing sufficiently to offset the downturn in the required rate of return, due to the decline in the cost of capital. By constructing separate time series for profits and capital, Barkai (2016) finds that the capital share has been declining while the profits share ‘increased dramatically over the past 3 decades’ (p.3) because of a downfall in competition and increased markups.

Following the insights of Stiglitz (2012) on economic rents and inequality, Furman & Orszag (2015) argue that, as has been happening with labour (Barth, Bryson, Davis & Freeman, 2014; Song, Price, Guvenen, Bloom & von Wachter, 2015), the dispersion of returns to capital across firms has increased and preceded the increase in the capital share. The concentration of capital in sectors with super-normal returns, due to economic rents, helps to understand of rising levels of economic inequality in the US.

3.10. Final remarks

In the theories reviewed above, stagnation emerges as an investment problem. To Hansen, the lack of competition to drive innovation, combined with the slowdown of demographic growth and geographic expansion, condemned investment opportunities to vanish. Keynes, on the other hand, explicitly referred that declining investment possibilities, combined with the saving habits of the bourgeoisie, could lead to a situation of persistent underemployment. Contrary to mainstream approaches, Keynes clearly dismissed the idea that saving and investment schedules could determine the natural interest rate, or even that the concept had any analytical utility at all. Yet his theory did not advance any consistent explanation for why should investment decline in the long run.

Kalecki identified the theoretical inconsistencies behind Keynes’s abstract idea that firms invest based on the relation between their marginal efficiency of capital and the interest rate. Instead, he puts forward a structural approach, in which investment decisions depend

on firms' market power, financial conditions, accumulated fixed capital stock and non-rational expectations about future profits. Through this structural approach, Kalecki introduced and specified missing links in the existing investment theories: i) the profit-investment nexus dissipates the conceptual wall between supply and demand; ii) financial conditions interact with investment decisions and balance sheet structures; iii) class relations and market power determine distribution of income between capital and labour, and of profits between different firms. Finally, there is no mechanism to ensure that this circular and potentially self-reinforcing distribution cycle ends in equilibrium — quite the opposite.

Steindl added an explicit stagnation argument to the structure proposed by Kalecki. *Maturity and Stagnation in American Capitalism* is based on a description of how competitive mechanisms operate in an oligopolistic market to bring about concentration of profits through markup setting, as well as excess capacity, which discourages fixed investment.

In Kalecki and Steindl, finance is introduced as a condition to the firms' investment capacity and understood as a facilitator of market concentration through stock markets. The Monthly Review School recovered Veblen's concept of wasteful expenditure to add yet another important financial dimension: explaining the malfunctioning link between profits and investments in the mature capitalist economies. Financial assets not only support the accumulation of surplus, but they provide an outlet for the realisation of that surplus in profits, concealing, or even causing, the structural lack of investment.

Recent empirical studies, based on industry-specific case studies, as well as recent macroeconomic developments in large economies, such as the USA, validate this line of reasoning. This literature reports growing levels of market concentration, related to declining labour shares of output, lower rates of GDP and investment, and systemic fragility.

One should refuse any temptation for deterministic or dogmatic interpretations of theories elaborated more than half a century ago. Nevertheless, theories of stagnation developed within the heterodox approaches provide important clues regarding where to look – the profit investment nexus – and how to look – an economic perspective focused on political and institutional dynamics.

The main idea to retain is that the maldistribution of profits due to the concentration of capital (in form of oligopoly) will depress investment.

Because these authors were mostly concerned with providing the basis for a structural yet general approach, some aspects in stagnation theories deserve further consideration.

The first is the emergence of market power. In Steindl and Kaleckian theories, monopoly power is determined by the capacity to set markups. The markup price theory explains – from the strict point of view of the firm — how monopoly power is exerted, but not how it forms. The Monthly Review School has worked on this limitation, by providing an historical account, in the line of Hilferding's *Finance Capital*, of how the development of finance has contributed to the concentration and cartelisation of capital. Indeed, finance is one of the elements, but not the only one, in the complex process of formation and reproduction of large conglomerates. This process changes according to the historical and socio-political contexts and should not be reduced to the dynamics of competition.

The second is related to factors – other than the utilisation of installed capacity — that might interfere with the profit-investment nexus of large corporations. Once again, the introduction of financial elements, proposed by the Monthly Review school, provides an important route for investigation. But here one should take into consideration other political aspects, explored by Kalecki in his approach to the political business cycle. At the core of this line of reasoning lies the idea that capitalists' efforts to enlarge and maintain more favourable power relations can be contrary to general welfare. Although Kalecki never mentioned it, this argument is very close to Veblen's concept of sabotage, explored in the next section in order to put together a possible framework to analyse Portuguese reality.

4. An institutional approach to stagnation

4.1. Introduction

Mainstream theories of stagnation are founded on fragile neoclassical grounds and characterised by a visible disregard for heterodox contributions to theory and methodology.

As a result, Wicksellian and Supply Side theories over rely on exogenous factors – unexplained advances in science and technology – or on very abstract concepts, such as

an hypothetical equilibrium in saving and investment markets caused by the natural interest rate.

Heterodox theories of stagnation, on the other hand, are mostly endogenous. The general idea underlying the underinvestment theories of stagnation is that companies with market power are able to set markups regardless of the phase of the cycle. Due to that capacity, these companies accumulate larger proportions of profits in relation to their investment conditions, causing an overall slowdown of fixed investment and, therefore, on aggregate demand.

There are two ways of interpreting these theories. The first is to employ the neoclassical view of monopoly pricing: entry barriers allow monopolies/oligopolies to charge higher prices – abnormal profits – in relation to the natural or efficient outcome of the market.

These views, usually associated with no-intervention stands, are based on the imaginary world of a free competitive market on which neoclassical models are grounded. In these models, ‘all the features of society which we would describe as the subject of institutional economics or political economy were deemed to be irrelevant for analysing production and exchange. In this imaginary world, to get any good, it was only necessary to pay the producers what they could earn in their next best alternative’ (Khan & Jomo, 2000, p.2).

The second way, closer to the intellectual context of its authors, is to place this process of generation of market power and its consequences within the concrete historical development of capitalism. This interpretation draws a direct line between heterodox economic thinking and some of the most important insights from classical economics: its long-run perspective; the notion that economic activities occur in the context of complex social and technical structures; the notion of surplus as the income accruing to property owners; and the importance of distributive conflicts.

It is useful to think the historical process of accumulation and concentration of capital as the process of generation and distribution of the economic surplus generated in the society. But, in order to do so, one needs to clarify the concept of capital and to step away from the notion of capital as a factor of production.

After stabilising the concept of stagnation for the purposes of this dissertation, chapter 4.2 discusses the several meanings of capital in the literature, complementing the preliminary discussion on the Cambridge controversies in the critical literature review (section 2.2.2). It is argued, based on the ideas of Veblen (1908a, 1908b and 1908c) and

Nitzan & Bichler (2009), that capital has a dual nature. It is power in its substance and money or wealth in its form. The true purpose of capital is not to allow capitalist consumption or investment, but to control the process of social reproduction, the process of creation and allocation of surplus.

If capital is not a physical entity or its monetary appearance, its accumulation does not necessarily correspond to economic growth and investment. On the contrary, it might generate undesired economic and distributive outcomes — what Veblen has named sabotage. Although the concept was exclusively used by Veblen, the main idea behind it is present in many of the heterodox contributions to the debate on stagnation and, in particular, on Kalecki's article 'Political Aspects of Full Employment' (1943). The purpose of section 4.3 is to present and explore the concept of sabotage, and to argue that, when linked to a broader understanding of capital, it can contribute to an institutional approach to heterodox theories of stagnation.

This intuitional approach is presented in section 4.3 and reinterpreted in the context of the concrete Portuguese economic reality in section 4.4. The first purpose of these sections is to identify those elements that were crucial to the process of accumulation and concentration of capital in Portugal, and that are not strictly linked to the production sphere. These are mostly institutionally, socially and politically determined realities that worked together to create an environment that, it is argued, was growth damaging to the Portuguese economy. The second purpose is to explain why and how these elements were growth damaging — in other words, why and how did the sabotage take place.

4.2. A definition of stagnation

Teulings & Baldwin (2014) define stagnation as the moment when the natural interest rate is too low to be achieved without negative real rates of interest. The problem with this definition is that it does not describe a visible economic phenomenon, only its consequences in terms of a specific theoretical framework. Neither is the natural interest rate a reliable concept, nor can the real interest rate have a straightforward impact on investment.

Apart for some ceremonial references to Hansen's (1939) work, this approach ignores the history of the concept, which places it far beyond a monetary dilemma.

The concept was first explicitly recognised by Hansen as 'sick recoveries which die

young in their infancy and depressions which feed on themselves and leave a hard and seemingly immovable ore of unemployment' (Hansen, 1939, p.33). Steindl never used the term *secular*, but his analysis pointed towards a secular and structural tendency for slower rates of capital accumulation: 'with the pattern of adjustment of the profit margin to be expected in modern times (owing to the predominance of oligopoly) a *primary* decline of capital accumulation will—via a reduced degree of utilisation—lead with a certain time lag to a further reduction in accumulation. This cannot easily lead to an equilibrium' (Steindl, 1952/1976, p.245). As for Sweezy and Magdoff, 'the real story of the system in its monopoly capitalist phase is determined by the interaction of the tendency to stagnation and the forces acting to counteract this tendency' (1987, p.27). Guthrie & Tarascio's (1992) broad definition of secular stagnation includes 'secular changes that diminish the economy's ability to adapt and to grow' (p.397).

The idea behind the concept is that of an ageing society going through a process of rapid growth and accumulation, and then entering a phase of maturity or stagnation. There are two main views on this ageing process. The first, present in the thinking of Malthus, but also Hansen's, as well as in contemporary environmentalism, concerns the exhaustion of natural resources. The second, patent in Luxemburg, Veblen or Marx, and then adopted by Robinson, Steindl, Kalecki or the Monthly Review school, sees this ageing process as the social evolution of capitalism. The main argument is that the concentration and accumulation of capital will generate stagnationist tendencies or inevitable crises.

Following this perspective, the study of stagnation should be placed within the problem of capital accumulation and concentration, and its distributive impact. The main assumption is that the process of accumulation and concentration of capital created tendencies which are contrary, not only to the stable functioning of the system, but also to its structural long-term development. Secular stagnation, in this sense, means what Guthrie & Tarascio (1992) suggested: 'structural changes that diminish the economy's ability to adapt and to grow' (p.397).

4.3. The political and institutional nature of capital

Capital has assumed many faces and meanings in economics literature, depending on the school of thought, but also on the context and methodological necessities of the moment.

In both mainstream and heterodox approaches, capital denotes financial wealth, although it very often means a stock of physical goods too.

The ambiguity around the concept of capital, as well as it being confused with a stock of fixed assets – a production factor –, is a source of some misunderstandings. Namely, it has led some to argue that accumulation and concentration of capital are equivalent, or necessary conditions to increase production, investment and economic growth.

Keynes's investment theory suggests that, in the long-run, the accumulation of capital – in the sense of investment in fixed assets – will lead to a decline of its marginal efficiency and, therefore, of the inducement to invest. However, this accumulation is seen as a macroeconomic aggregate, without any consideration whatsoever on the property system behind and underlying it. In fact, the theory is built on the assumption of perfect competition. Moreover, the mechanisms by which the marginal efficiency of capital is supposed to be brought to a long-term decline require the gift of perfect foresight.

These shortcomings were identified and partially avoided in Robinson, Kalecki and Steindl's contributions. The long-term result is similar, but the method is different. In the presence of oligopoly power, the system will remain in a situation of excess capacity and under-investment. Capitalists make investment decisions based on the concrete conditions of the moment and not to match today's costs with future hypothetical equilibrium prices.

These authors have avoided the confinements of perfect competition and cognitive superpowers, but their investment theories have also often disregarded the political and institutional aspects behind market power.

It should not be matter of disagreement that oligopolies, or large dominant firms, are the outcome of a process of concentration and accumulation of capital. However, as their power is not just the power to produce and set prices in a market economy, it is also political and financial power; the process of concentration and accumulation is not (and was never) just the collection of larger stocks of physical assets. Today, the power of companies like *Amazon* or *Google* is not based on their large stocks of industrial assets.

It is therefore necessary to go back to a broader definition of capital, in the light of Veblen's contributions. Let us recall the main ideas in dispute in the capital controversies: on the one side, the neoclassical theory of capital as a factor of production, remunerated according to its contribution to output; on the other, capital as a non-material entity whose

contribution to production cannot be disentangled from the very distribution process that creates value. Unlike Robinson, who was more focused on discussing the particular aspects behind measurement and distribution, Veblen was more interested in the nature of capital.

To Veblen, 'capital is revealed in two technical dimensions: productive assets (as form) and technology (as substance). Capital is also revealed in two other dimensions: namely the institutional ones of ownership (as form) and dominance (as substance)' (Davanzati & Pacella, 2017, p.127). Hence, capital is the technology (in the sense of productive practices and knowledge), as it is collectively accumulated and privately appropriated by the owners of the means of production. In this sense, capital is not the sum of capital goods, but their ownership and all that the ownership process entails. Accumulation of capital is not equivalent to the accumulation of capital goods, but rather the accumulation of financial and social power in the hands of the owners of those goods, sometimes at expense of production:

'The ownership of the capital goods affords a discretionary power of misdirecting in the industrial process and perverting industrial efficiency, as well as inhibiting or curtailing industrial processes and their output, while the outcome may still be profitable to the owner of the capital goods.' (Veblen, 1908b, p.108)

A second aspect of Veblen's view that differs from the neoclassical production function theory is that while, in substance, capital is ownership and power, in form, though, it is always a money concept:

'It is plain that if the concept of capital were elaborated from observation of current basic business practices, it would be found that "capital" is a pecuniary fact not a mechanical one; and it is an outcome of a valuation, depending immediately on the state of mind of the valuers; and that the specific marks of capital, by which it is distinguishable from the other facts, are of immaterial character.' (Veblen, 1908c, pp.163-164)

Based on these insights and the contribution of Nitzan's and Bichler's book, *Capital as Power* (2009), capital, throughout this dissertation, is understood as an economic but also socio-political entity, with a dual nature.

In form, capital is money: money as finance, or debt, embodied in tangible and intangible assets, in stocks issued or in the financial assets kept in the balance sheet. Capital as money can be measured using the par value of a certain balance sheet or, more correctly,

its market value – or capitalisation. Capitalisation is the process by which the capitalist system converts different aspects of society, more or less linked to the economic or financial realm, into universal money quantities (Nitzan & Bichler, 2009, p.166). In this sense, capital is ‘capitalised presumptive earning capacity’ (Veblen, 1904/2013) and ‘for the capitalist, the real thing is the *nominal capitalisation of future earnings*. This capitalisation is not “connected” to reality: it is the reality’ (Nitzan & Bichler, 2009, p.182).

In substance, capital is power, or dominance: power to control and dominate the production process, to influence and determine public policies, to exploit labour and shape the process of social reproduction.

The accumulation and concentration of capital is, therefore, the accumulation and concentration of capitalised wealth and power. There can be certain periods in history when the capitalist drive for accumulation and concentration matches the accumulation of fixed productive assets and the development of the productive system. However, in contrast to the beliefs of neoclassical economics and its modern interpretations, the accumulation of capital in hands of the captains⁴⁴ is not a pre-condition for more or better investment. On the contrary, in the long run, or for long periods of time, a counterproductive accumulation process can emerge, as the pecuniary and strategic interests of the capitalist class damage economic stability and general welfare. Veblen has named the inefficiency resulting from the strategic private use of capital as sabotage, but the concept also appears, in a different form, in Kalecki or Keynes.

4.4. Capitalist sabotage in Veblen and Kalecki

At the core of Veblen’s intellectual contributions lies a singular understanding of the institutional and political nature of capitalism. Veblen was well aware of the historical evolution of the economic system, its institutions and inherent contradictions, and that awareness motivated his persistent criticism of the unrealistic and overly abstract methods of economic theory:

‘There are certain saving clauses in common use...: “Given the state of the industrial arts”; “other things remaining the same”; “In the long run”; “in the absence of disturbing causes”. Now ..., the state of the industrial arts has at

⁴⁴ The term ‘captains of industry’ was coined by Thomas Carlyle in 1843 to refer to 19th-century industrialists. It was frequently used in political economy literature, namely by Veblen and Kalecki, to refer to the largest capitalists in finance and industry.

no time continued unchanged during the modern era; consequently other things have never remained the same; and in the long run the outcome has always been shaped by the disturbing causes ... The arguments have been as good as the premises on which they proceed ...' (Veblen, 1919/2010], Chap.5, Para.1)

Theory of Business Enterprise (1904/2013) provides an evolutionary analysis of modern capitalism and of the growing incompatibility between the industrial productive process and the interests of business and financial activities. It is on this fundamental contradiction and its consequences that we find the central element of Veblen's macro theory of business cycles and chronic depression, or stagnation.

The analysis opens with the evolution in the motives of businessman as the modern economic and industrial process unfolds:

'A further feature of that pre-capitalistic business situation is that business, whether handicraft or trade, was customarily managed with a view to earning a livelihood rather than with a view to profits on investment ... [w]ith a fuller development of the modern close-knit and comprehensive industrial system, the point of chief attention for the business man has shifted from the old fashion surveillance and regulation of a given industrial process, with which his livelihood was once bound up, to an alert redistribution of investments from less to more gainful ventures, and to a strategic control of the conjunctures of business through shrewd investments and coalitions with other business man.' (Veblen, 1904/2013, pp.17-18)

As the modern industrial system developed, the purpose behind production changed from a matter of survival to the chance of earning profits. The 'industry is carried on for the sake of business, and not conversely' (p.19). Consequently, disturbances in the complex business system are transmitted by business relations regardless of the mechanical processes of industry. Even more, the financial (pecuniary, in the words of Veblen) nature of production implies that the interests of great businessmen with vast industrial and economic fortunes are not always coincident with the smooth working of the industrial system. In other words, large capitalists may benefit individually from specific disturbances in the industrial system, even at expense of general welfare.

The interest of the captains of industry is to control larger parts of some industry, either permanently or strategically, in order to potentiate further gains, by means of damaging competitive wars:

'It is notorious ... that the great business coalitions and industrial combinations which have characterized the situation of the last few

years have commonly been the outcome of a long-drawn struggle, in which the industrial ends, as contrasted with business ends, have not been seriously considered ...' (p.24)

The result is a 'chronic perturbation' (p.23) of the industry, caused by the business methods of the captains. Industrial consolidations can be delayed, suspending possible technological and organisational benefits, or anticipated, without any industrial gains. By eliminating competitors, the captains curtail work and reduce business opportunities for other companies: 'It is a casting out of business men by the chief of business men' (p.29).

As a result, 'it is very doubtful if there are successful business ventures within the range of the modern industries from which the monopoly element is wholly absent.' (p.32)⁴⁵

Large decisions on industrial organisation are rarely motivated by the 'mechanical exigencies of the industrial processes' (p.29), but very often by perceptions of changes in the value of investments. Concrete decisions on production are determined by the captains' concern over the realisation of their gains, i.e., the conversion of their output into money values. As a result, the link between the serviceability (in the sense of usefulness for the community) of a certain business activity and its remuneration disappears.

Veblen takes this line of reasoning even further, arguing that activities that exist merely to ensure profits to businessmen and are not engaged in the mechanical process of industrial production are parasitic activities. Eventually, the amount of money directed to those activities will have to be deducted from the income of those who keep the production going. This idea of wasteful expenditures or waste was recovered by Baran and Sweezy in *Monopoly Capital* (1966) to label activities that support demand and the realisation of surplus but that have a long-term negative impact on growth and economic stability.

In his evolutionary analysis, Veblen pays particular attention to the historical antecedents of the modern institution of property, commonly envisaged as the product of free labour and an individual right, instead – as argued by Veblen – of a given privilege. With the growing importance of property contracts, all aspects of the business process came to be expressed and measured in money values. The pecuniary principles of capitalism establish that the main goal is no longer the efficiency or quantity of industrial production,

⁴⁵ Monopolies can be formed by legal means, by the control of natural resources or by long lasting prestige and branding (goodwill).

but the capacity to earn profits. It is based on this capacity that the capitalisation of a business organisation is determined, replacing the previous understanding of business capital as the fixed capital invested in the firm.

The use of credit is an intrinsic element of modern forms of business. Veblen identifies two main situations in which credit plays an important role, anticipating crucial elements of the monopoly capitalism that emerged after the Second World War.

The first is the use of credit to increase business capital, which became a current device in the corporate competitive environment. These credit operations have no aggregate impact on the industrial output and affect only the value of businesses.⁴⁶ Moreover, because of interest payments, the use of credit diminishes industrial profits. The injection of new money into businesses swells the value of the collaterals and allows for new credits to take place. This process will go on until the discrepancy between the market value of the collateral and its real material value is noted. Then, deflation sets in, leading to a wave of liquidations that ultimately change the ownership of industries. This description is very similar to Minsky's approach to business cycles and crises.

Credit markets are crucial to the financing of complex market operations, such as business reorganisations or coalitions, as well as to distribute business capital afterwards. The capital that results from these mergers exceeds the mere addition of the previous existing materials. In fact, these financial operations might not have an industrial counterpart. The greater value of capital is the result of the capitalised goodwill resulting from the reorganisation. Therefore,

“Capital’ in the enlightened modern business usage means “capitalised presumptive earning-capacity”, and in this capitalization is comprised of usufruct of whatever credit extension that given business concern’s industrial equipment and good-will support. By consequence the effectual capitalization (shown by the market quotations) as contrasted with the nominal capital (shown by the par value of the stock of all descriptions) fluctuates with the fluctuations of the prevalent presumption as to the solvency and earning-capacity of the concern and the good faith of its governing board [emphasis added].’ (Veblen, 1904/2013, p. 65)

⁴⁶ Veblen seems to understand the process of endogenous money creation by the banking system. However, his own explanation on why this newly created money can only trigger a process of asset inflation and can never be used to add to industrial uses suggests that he differentiates between different types of money. In chapter VII the discussion on the inflationary processes of change in the supply of precious metals also point in that direction.

In sum, the basis of capitalisation of modern enterprises depends not so much on the material employed in production, but rather on the possible future earning capacity. So, a difference emerges between nominal (*de jure*) and effective capitalisation. A major component of this difference is goodwill, defined as ‘all the items [that] give a differential advantage to their owners, but ... are of no aggregate advantage to the community’ (p.71). This capitalisation is represented in the market by financial securities, in the form of stocks or bonds.

The mismatch of material business and market capital has two consequences. The first is that the interest of managers and owners must not coincide at all. The second is a large room for speculation.

The characteristics just described are suitable for a credit economy (as opposed to a natural economy). In this type of economy, crises cannot be approached from the point of view of the ‘mechanical facts of production and consumption’, but ‘from the side of business enterprise – the phenomena of price, earning, and capitalization’ (p.90).

In the words of Veblen,

‘Depression and industrial stagnation follow only in case the pecuniary existences of the situations are of such a character as to affect the traffic of the business community in an inhibitory way.’ (p.103)

In an article written in 1921, *The Engineers and The Price System* (1921/2001), Veblen goes back to the argument that profit strategies, or the pecuniary interests of businessmen, are contrary to the interests of the economy as a whole. The term sabotage is rescued from its ‘unfortunate’ common use to describe the resistance tactics of trade unions and organised workmen and also applied to the strategies of restriction, delay and obstruction carried by businessmen (p.2).

Sabotage describes ‘a resort to peaceable or surreptitious restriction, delay, withdrawal, or obstruction’. Furthermore, ‘sabotage commonly works within the law. Although it may often be within the letter rather than the spirit of the law. It is used to secure some special advantage or preference, usually of a business-like sort. It commonly has to do with something in the nature of a vested right, which one or another of the parties in the case aims to secure or defend, or to defeat or to diminish; some preferential right or special advantage in respect of income or privilege, something in the way of a vested interest.’ (Veblen, 1921/2001, p.2)

With the development of the capitalist business enterprise and modern property institutions, the power to organise the production process was taken away from the hands of engineers and technological experts to be at the service of one-eyed captains of industry, concerned with financial gains only. Their profit strategies focused on the restriction of industrial production below the installed productive capacity in order to sustain artificially higher prices. This process of withdrawing from production to sustain higher markups and profits, which Veblen named sabotage, was reinterpreted in Kalecki's and Steindl's theories of stagnation and market power. However, to Veblen, strategies of sabotage also included concentration and cartelisation, as well as deception of clients, regulations and governments.

In this broader sense, sabotage is part of the natural method to organise a country's industry, to control and regulate output, sometimes at the expense of economic and social stability and welfare. Sabotage is the result of captains exerting their power. But the source of that power is not merely financial; it is also social, political and cultural. And it implies dominance over institutions, including the State:

‘The quest of profits leads to a predatory national policy. The resulting large fortunes call for a massive government apparatus to secure accumulations, on the one hand, and for large and conspicuous opportunities to spend the resulting income, on the other hand; which means a militant, coercive home administration and something in the way of an imperial court life ...’ (Veblen, 1904/2013, p.188)

The Theory of the Leisure Class (1899/2009) develops the idea of the historical process of predominance and oppressiveness of the leisure class through force and fraud. In this context, fraud meant the construction of strong ideological narratives that promote and protect the interests of the ruling class — in Gramscian terms, the hegemony of the bourgeoisie.

Kalecki's economic contributions took a different route from that of Veblen's work, and there is no evidence that the latter influenced in any way the Polish economist's thinking. However, both authors understood the importance of applying an evolutionary framework of analysis and shared their concern with the ongoing process of concentration of market power and its consequences.

Although Kalecki was often focussed on the ‘purely economic aspects’ of specific phenomena, such as unemployment, he was well aware of the importance of also giving ‘due consideration to political realities’ (Kalecki, 1943, p.75). The discussion in ‘The

Political Aspects of Full Employment' (1943), focuses on those realities and, in particular, on the contradictions between the political interests of the business class and the general economic outcome:

'... "discipline in the factories" and "political stability" are more appreciated by the business leaders than are profits. Their class instinct tells them that lasting full employment is unsound from their point of view and that unemployment is an integral part of the normal capitalist system.' (p.79)

To be clear, in this article, Kalecki did not discuss underemployment as the outcome of purely economic dynamics of investment and aggregate demand (although he recognised the political nature of distributional aspects behind those dynamics), but as the direct result of the political pressure of the captains instead. It is sabotage, in its crudest form.

In Kalecki's argument, presented in the context of the world economy in 1943, the possibility of policies capable of achieving full employment through public spending was undermined by the will of a coalition between rentiers and big business. Even if this result seems at odds with the overall economic interests of the business class (since it would prevent higher levels of aggregate demand and, hence, income) three reasons motivate their opposition: i) dislike towards the idea of the government interfering in employment as such; ii) dislike towards the way public resources are being spent; iii) concerns over the result of such policy in terms of changes in the balance of power between workers and capital:

'As has already been argued, lasting full employment is not at all to their liking. The workers would "get out of hand" and the "captains of industry" would be anxious to "teach them a lesson". Moreover, the price increase in the upswing is to the disadvantage of small and big rentiers, and makes them "boom-tired".

In this situation a powerful alliance is likely to be formed between big business and rentier interests, and they would probably find more than one economist to declare that the situation was manifestly unsound. The pressure of all these forces, and in particular of big business -- as a rule influential in government departments -- would most probably induce the government to return to the orthodox policy of cutting down the budget deficit. A slump would follow in which government spending policy would again come into its own.' (Kalecki, 1943, p.4)

While Veblen considered the pecuniary interests of individual capitalists engaged in competition wars and strategies to secure profits, Kalecki described the political behaviour of capitalists to protect their *status quo* as a class. It is interesting to note that

Keynes put forward a similar argument, in 1943, when he wrote in *The Times* that ‘the first function of unemployment ... is that it maintains the authority of masters over men’ (Keynes in *The Times*, 23 January 1943).

A broader understanding of sabotage can also include some of the key arguments in heterodox stagnation theories.

For Steindl, sabotage materialises in the form of excess unused capacity – due to the prevalence of oligopolies – that cannot be eliminated through the normal mechanism of competition. Excessive capacity discourages new investments and threatens the generation of the demand necessary to realise future profits.

On the other hand, overcapacity cohabits with unemployment and downward pressure in wages, which contribute to lower demand through consumption spending. The growing importance of wasteful expenditures as an escape route to rarer investment opportunities is present in the writings of Veblen, Steindl and the Monthly Review school.

In a famous debate with Schumpeter in 1947, Sweezy noted that the economic system has no automatic mechanism to adjust investment opportunities to capitalists’ accumulation needs (Foster & McChesnay, 2012). Once the chances for investment wear down relatively to the accumulation of investment-seeking surplus, these oligopolies (and the economy) will rely on external stimuli – government spending (mostly military), sales efforts and financial activities. Magdoff & Foster (2009), as well as Foster & McChesnay (2012), followed up on Sweezy’s stagnation theory to argue that the decline in real growth rates led to an increase in speculative activities – finance, insurance and real estate –, responsible for higher shares of the GDP. The side effect of this turn to speculative activities is the generation of a permanent and systemic instability, which can also be seen as sabotage.

4.5. Putting together the elements for an institutional approach to stagnation

The framework developed in this chapter is based on the initial idea that capital cannot be seen as a stock of fixed capital (instruments of production) or a mere money fund. Capital embodies relations of power. Its accumulation does not take place through an ascetic market game between entrepreneurs. It is an unequal process, determined by class relations and balances of power at specific historical periods.

If capital is not a physical entity, its accumulation does not necessarily correspond to economic growth and investment. On the contrary, the processes by which capital is accumulated and allocated might generate undesired economic and distributive outcomes — sabotage.

Furthermore, if capital is not a physical entity, its creation and allocation — the base for market power — occurs mainly outside the strict functioning of the production process. Classical economists, sociologists and political scientists alike were well aware of the complex and multidimensional nature of these phenomena, as well as of the vast range of possible outcomes associated to it.

There are three elements that deserve closer attention, since they seem to be transversal to the historical process of accumulation and concentration of capital: family networks, the relation between the State and business elites and the access to finance. These are the elements that, combined, determine not only the main beneficiaries of capital accumulation, but also the economic outcomes of those processes of accumulation.

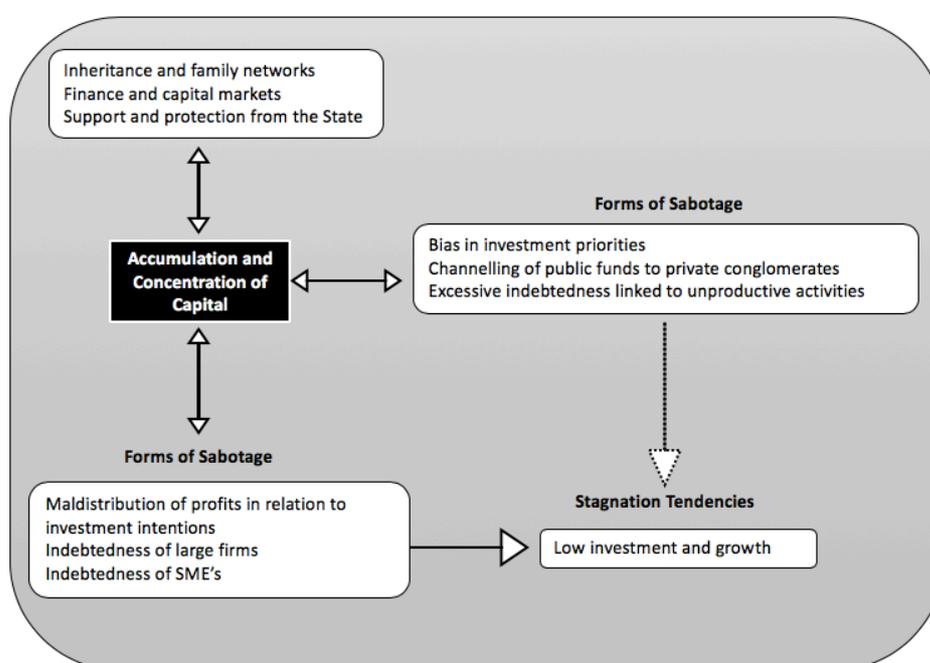
Khan & Jomo's (2000) original discussion on rents and rent seeking processes is of great importance to the present debate. The main idea to retain is that the productive framework of analysis is not one that opposes a mirific perfectly competitive environment to a pathological market system, disrupted by social and political interventions. All these elements – family, finance and State – reflect the intrinsically political and social nature of economic relations. The question is not to know if these elements exist, but in what ways they have shaped the organisation of the economic system and its outcomes in terms of growth and investment. There can be positive but also negative outcomes, here denominated as sabotage. Sabotage, therefore, refers to the concrete forms in which the organisation of the processes of accumulation and concentration of capital negatively affects the general economic outcome.

The scheme in Figure 11 clarifies the framework proposed. Let us take, as a starting point, the factors that determine the creation and concentration of capital. These elements – family networks, finance and State – can interact to generate a specific regime of accumulation that is contrary to investment. This regime is characterised by a dialectical and self-reinforcing relation between the very strategies that allow the accumulation and concentration of capital and different forms of sabotage.

This dissertation explores two perspectives on sabotage. The first concerns the institutional — or qualitative — aspects of the constitution and functioning of such regime, whereupon the processes of concentration and accumulation of capital are disentangled from investment. The second addresses the distributive effects of a market concentrated structure in terms of profits and relative indebtedness capacity, and its relation to investment, in the light of Steindl and Kalecki stagnation theories.

The key aspects of the framework just outlined will be developed in the next subsections.

Figure 11 - Analytical framework



4.5.1. The historical process of accumulation and concentration of capital

In Steindl and Kalecki's theories, market power is determined by the capacity to set markups. The markup price theory explains – from the strict point of view of the firm – how monopoly power can be exerted, but not how it is formed. The formation and reproduction of large conglomerates differs in different historical and socio-political contexts.

Toporowski (2016a) argues that accumulation and concentration are more than the outcome of the production process, and points to the pivotal role of capital markets:

‘Monopoly is not the outcome of operations in markets for goods and services, where monopolists may happen to have a dominant position, but is instead the result of their operations in the capital market. The dominant corporations of today, such as General Electric, Tata, Boeing, or Microsoft, did not achieve their pre-eminence through their ability to produce electrical equipment, steel, aircraft, or software better than their competitors, but by buying up those competitors in the stock market’ (para.14).

I argue that, in order to explain the historical process of creation and allocation of surplus — and, therefore, that of capital —, it is important to explore specific mechanisms that do not necessarily operate within the production sphere: family networks, finance and the State. The interaction between these elements determines, to a large extent, the long-term shape of the specific regime of accumulation.

Inheritance and family networks

Inheritance is crucial to the process of accumulation and concentration. That fact was recognised in a special report on family companies published by *The Economist* in 2015. While drawing attention to the importance of this type of companies — 40% of German and French and 1/3 of US companies with revenues above 1\$million a year — the report also points to a key issue in the accumulation process: ‘academic theorists reflecting on the reasons why firms exist will need to add one more: their role as a mechanism for the transmission of property to future generations’ (*The Economist*, 2015).

The transmission and enlargement of property and wealth from generation to generation is instrumental to the concentration of capital in the hands of the captains. The international examples of long-lasting dynasties are well-known: Baretta, the Italian firearm manufacturer; the Rotchschilds, in the financial sector; the Barings, who founded the Barings Bank in London in 1762, bankrupted in 1995; the car empires of Ford, Daimler-Benz, Sozuki, Toyota and Ferrari; high couture brands Versace and Gucci; the Walton family, heirs of the retail chain Walmart.

Some of these families control large parts of their respective national economies. As reported by Louçã & Ash (2018), the Agnelli family controls 10% of the stock market in Italy; the wealth of the largest fifteen families in Hong Kong corresponds to 84% of the GDP, 76% in Malasya, and 48% in Singapore. In Sweden, the two largest groups owned

63% of the market capitalisation, whereas in Portugal, the top ten families controlled 34% of the market capitalisation before the crisis.

The formation and organisation of family conglomerates are not short-term processes. Their areas of interest are historically determined by the existing incentives, depending on the stage of development of their base economy and the specific economic and industrial policies in place. As noted by Khan & Jomo (2000, p.3), ‘institutional change almost always involves the creation or destruction of rents’, and the direction and characteristics of those rents can determine – and sometimes be determined by – the interests of these powerful families.

Family conglomerates tend to prioritise the effective control of their shareholdings and be averse to forms of capitalisation that could endanger it. This preoccupation promotes particular forms of corporate structures: cross-ownership of shares and pyramidal chains of holding companies are commonly used to minimise the cost of capital and improve the circulation of liquid funds. Depending on the development of the financial system, the integration of financial activities – through the acquisition of banks, for instance – can emerge as a response to these concerns. The result is the appearance and dominance of large mixed conglomerates, spread across a wide range of interlocked activities, including banking.

The historical long-term processes of formation and organisation of family conglomerates require not only the protection and transmission of property – through legal, regulatory and economic rights – but also the reproduction of financial and political relations.

There are many international examples of the importance of politics to maintain and enlarge the power of family business dynasties, but also the other way around: the Kennedy and Bush families in US, the Le Pen in France, Papandreou and Karamanlis in Greece, the Fujimoris in Peru (Louçã & Ash, 2018, p.124). According to Faccio (2006), 8% of the world market capitalisation corresponded to firms controlled by family members of ruling political leaders.

In sum, family networks and heritage should be accounted for in the analysis of any specific process of concentration and accumulation of capital. This is not to say, however, that family-type organisations are naturally inferior to others, either market based or Anglo-American institutional forms. Literature on industrial policy and economic history

has already shown that the development of the capitalist system is associated to many different types of business organisations (Chandler, 1990).

The controversies around the Korean Chaebols⁴⁷, its outcomes and contribution to the financial crisis of 1997 illustrate the complexity of this theme.⁴⁸ On the one hand, the complex system of intra-group shareholding and its close relationship to the government may have protected these conglomerates from short-term instability, while including them in a larger project of industrial development; on the other hand, their abuse of political and economic power, plus the tendency to operate in over capacity, constituted real problems to the Korean economy (Chang & Park, 1999).

The benefits and damages of specific business forms will always depend on the institutional and political characteristics of its historical and national contexts and cannot be properly analysed if these aspects are ignored.

Finance and capital markets

Finance is the most widely discussed aspect in the processes of accumulation and concentration of capital. Capital market operations allow large firms to turn into conglomerates, as they thus satisfy two simultaneous necessities: the generation of financial means through debt and the transformation of property into liquid assets. As pointed by Steindl, larger companies can issue shares at relatively lower costs, facilitating processes of financial concentration. Holding company structures allows for new share issues, avoiding the risk of diluting the shareholder control of dominant firms. Corporate finance emerged to manage these large and complex structures, with three goals. The first is to minimize, or save, equity. The second is to maximize leverage and to keep a constant flow of financial payments to sustain debt structures. The third is to obtain short-term financial gains through capital and stock market operations.

Capital, as power, also requires financial wealth. However, both historically and analytically, the formation of that wealth is more related to the capacity to generate debt than to some pre-existing endowment of savings. Access to banking finance is one of the

⁴⁷ The Chaebols are powerful family-based conglomerates in South Korea. Their role in the rapid economic growth of the country in the 1990's and the financial crisis of 1997 is the theme of an important debate in development studies (Jwa and Lee, 2004; Chang and Park, 1999; Khan and Jomo, 2000).

⁴⁸ See Chang & Park (1999) and Jwa & Lee (2004).

key aspects explaining why some firms remain small while others thrive into large powerful conglomerates.

It is widely accepted that finance and, to a certain extent, financial leverage are crucial to the generation of wealth and to support all types of economic relations in capitalism. Furthermore, it is almost impossible to draw the line dividing the productive or sustainable from the unproductive or unsustainable uses of finance. Nevertheless, there are aspects in the organisation of the financial system – ownership structure, level of liberalisation, structure of incentives – that can influence its concrete uses and economic outcomes.

The State

Post-Keynesian analyses tend to disregard the full latitude of the State's role in shaping and organising the capitalism system. These analyses look at the State as the element in dispute when considering the best economic policies, but ignore the complexity of social, political and institutional relations behind those disputes. This is precisely the point made by Kalecki in 'Political Aspects of Full Employment' (1943).

As has been thoroughly argued, the capitalist mode of production is not just a set of productive relations. It requires a legal, ideological, cultural and political superstructure that ensures its own acceptance, organisation and reproduction. The State is crucial in the organisation of this multileveled power, and it should not be seen as an independent entity that has either surrendered to or been co-opted by the business class.

Every nation is the exercise of national bourgeois political power (and its interaction with the working class), legitimised by the State. This idea was carefully explored by Veblen, who understood the State as a social institution, inseparable from other economic institutions: 'A constitutional government is a business government ... representative government means, chiefly, representation of business interests'. Moreover, the identification between the State and the interests of the capitalist class is such that the interests of the latter are often presented as those of the Nation: 'The largest ... factor of cultural discipline ... over which business principle rule is national politics ... Business interests urge an aggressive national policy and business man direct it' (Veblen, 1904/2013, p.391).

In this conception, any nation, or national social formation, is always the product of, and influenced by, the specific forms of organisation of capital under a State. Underlying these forms of organisation are laws and relationships that shape and coerce individual capitals into the greater functioning of the capitalist mode of production. Marx saw competition as a disciplinary instrument that pushes individual capitalists to act as a class. However, as described by Steindl, as the competition process occurs, especially among smaller units, a concurrent ongoing process of concentration in largest companies and economic groups takes place. This process requires the coercive or legal hand of the State to open up new territories and exploit natural resources, to operate in activities that constitute natural monopolies, to control and limit external and internal competition in order to ensure profit rates, to create public rents, and so on. The instruments and ways of intervention are practically unlimited.

Governments can support the creation of economic conglomerates and favour the accumulation of wealth in two main ways. First, via the direct access to public resources through public contracts, loans, concessions, licences, joint-ventures, and so on. Secondly, by the creation of custom-made legislation, to secure markets, exploit tax loopholes and protect concentration practises.

Several examples illustrate the pivotal role played by governments and political institutions in fostering profit opportunities for large conglomerates.

As reported by Oxfam in the paper ‘An Economy for the 99%’ (Hardoon, 2017, p.4), ‘corporations from many sectors – finance, extractives, garment manufacturers, pharmaceuticals and others – use their huge power and influence to ensure that regulations and national and international policies are shaped in ways that enable continued profitability’. What emerges is a regime of crony capitalism, that ‘benefits the rich at the expense of the common good. It means that ordinary people end up paying more for goods and services, as prices are influenced by cartels and the monopoly power of corporations and their links to government. In crony capitalism, corporations use their connections to secure lax regulations and lower taxes, depriving governments of revenue.’ (p. 19)

Furthermore, Oxfam estimates that ‘one-third of the world’s billionaire wealth is derived from inherited wealth, while 43% has some presumption of links to cronyism. (...) These findings are echoed by similar exercises carried out by The Economist and others,

undermining the idea that the majority of the super-rich owe their fortunes to hard work and merit.’ (p. 20)

It is important to note that any governmental intervention in the economy, whether following a more liberalising or interventionist agenda, has a distributive impact. And different types of policies are linked to the creation of different types of rights and privileges in the economy and society. The main issue is to identify the specific groups favoured by these interventions, the motivation supporting its design and implementation, as well as the economic outcomes associated.

4.5.2. Dialectics of sabotage and stagnation

This dissertation explores the idea of sabotage from two different, though related, perspectives. The first addresses political and institutional aspects that are usually outside the scope of stagnation theories and strict definitions of market power. The second focuses on the main links suggested by Steindl’s and Kalecki’s theories of stagnation that relate the concentration of market power – monopoly power – to the distribution of profits and investment.

The hypothesis underlying the first perspective on sabotage is that the mobilisation of finance, family, political networks and the power of the State can contribute to create a specific regime of accumulation which is detrimental to investment and economic growth. This effect can occur through three main channels.

The first channel is bias in investment priorities, determined either by short-term profit motivations or by the strategic interests of big business owners. This bias can be set off by the influence of private groups over governmental policies – incentives, public contracts, regulations –, or by the absence of government policies capable of determining priority investment areas, leaving the room for over-investment in speculative or ‘parasitical’ activities. It should be noted that the growing importance of ‘wasteful expenditures’ as an escape route to rarer investment opportunities is present in the writings of Veblen, Steindl and the Monthly Review theory.

The second channel is related to the channelling of funds to private conglomerates by crowding out public funds or by setting higher price markups. The crowding out effect occurs when there is a transfer of public money that clearly benefits private counterparts: public contracts, exploitation of privatised monopolies or concession of profitable areas.

The markup channel arises as the result of tailor-made regulations that affect the final price charged for a good or service, or of market power. The consequences are, on the one side, the weakening of the State's capacity to put in place public investment policies and programmes and, on the other, maldistribution of profits towards larger firms. This last channel will be thoroughly developed in the second perspective on sabotage.

The third channel concerns excessive indebtedness linked to unproductive activities and the 'empire building' strategies of the owners of large conglomerates. Indebtedness appears here as the outcome of speculative investment priorities or of market operations aimed at dominating particular companies. The macroeconomic impacts of such practices depend on the size and prevalence of these conglomerates, but also on their relationship with the banking system. Besides the financial fragility associated, the concentration of debt in specific sectors and companies can affect the overall levels of investment negatively. This channel will also be developed from a different angle in the second perspective on sabotage.

If present, these forms of sabotage can damage the (theoretical) link between profits and investment. Accumulation and concentration strategies employed by large conglomerates do not depend on the overall level of investment or economic development, and they might even damage it. It is a situation of profits and indebtedness without investment and economic growth, very close to the descriptions found in the Monthly Review theories of stagnation.

The relationship between debt, profits and investment priorities takes this discussion back to the heterodox theories of stagnation, and to the second perspective on sabotage developed in this dissertation.

The key element in Kalecki's and Steindl's theories of stagnation is investment and its determinants, namely the principle of increasing risk. As argued by Toporowski, 'Kalecki's principle of increasing risk, as developed by Steindl, suggests a liquidity preference theory of investment' (2005, pp.125-126).

The starting point is the idea that firms must regulate their capacity to meet future financial commitments — or, in other words, that firms must regulate their liquidity. There are two ways to do so. The first is to manage investment decisions, postponing or anticipating new projects, according to the need to have more or less liquid reserves

available. The second is through credit and capital markets, by borrowing or issuing new stocks.

If firms chose to reduce fixed investment to maintain reserves, Kalecki's reflux theory suggests a cumulative negative effect on future investment due to a decline in profits. The second option is to finance the balance sheet through loans, bonds or stocks. Issuing new capital is the safest way to meet financial needs, but it is also expensive, largely reliant on demand and has the downside of diluting the existing shareholders' position. Debt is, therefore, the most common solution. Although financing investment through borrowing is possible, the consequent increase in financial liabilities brings additional risk and higher future financial payments, putting more pressure on future investment projects. It should also be considered that there is no rule stating that borrowing is linked uniquely to investment. Financial liabilities can be issued to back other financial investments, namely for speculative reasons, to take advantage of good market conditions, or to support concentration through mergers and acquisitions. In this case, not only can a decline in fixed investment relative to finance – financial assets and liabilities – raise indebtedness, as predicted by Steindl, but the rise in finance relative to the same investment would have similar consequences. The overall long run result is a downward tendency in investment: 'In Kalecki and Steindl, the reflux of investment comes to profits, and external indebtedness increases by the amount by which investment fell short of saving' (Toporowski, 2005, p.129).

Steindl's theory of stagnation allows us to take this reasoning further, by questioning how this process affects firms according to their relative size, or power, in Kalecki's terms. Here, too, several cumulative depressing pressures on investment coexist. Small and medium enterprises are less capable of having access to financial markets and finance investment through retained profits. According to the principle of increasing risk, their financial elasticity is lower and, therefore, these firms are also more prone to postpone investment projects in order to manage liquidity. Despite relying on internal savings, they obtain a relatively smaller share of return of past investments in the form of profits. This does not imply that these companies are necessarily responsible for a smaller share of investment, only that the additional profits are unevenly distributed. It is a maldistribution of profits in favour of large companies, according to their degree of monopoly.

The consequence of this process is the concentration of profits in a reduced number of companies, which will not be invested in the same proportion, generating a pool of

condensed surplus. The overall effect is a decrease in investment together with an increase in indebtedness; or, in other words, the emergence of strong stagnation tendencies in the accumulation of fixed capital, even if capitalist accumulation proceeds and prospers.

4.6. Final remarks

This chapter combined elements from different theoretical traditions to put forward an original framework for the analysis of stagnation in Portugal. Unlike mainstream theories, this framework does not follow a monetary – focused on the impact of the natural interest rate on investment — or supply side – focused on the exogenous impacts of technological breakthroughs or undesired government interventions — approach. The analytical framework outlined in Figure 11 is predominantly institutional, as it results from a political and institutional interpretation of heterodox theories of stagnation, as proposed by Steindl, Kalecki and Sweezy.

First, the concept of capital was clarified to include, not only the stock of physical instruments in society, or its monetary value, but also relations of power that dominate the reproduction process. This interpretation unveils the political and institutional nature of the processes of accumulation and concentration of capital.

Secondly, Veblen's concept of sabotage was used to refer to the negative economic outcomes of strategies employed by large capitalists, concerned about their control over (and gains from) those processes of accumulation and concentration.

In heterodox theories, the emergence of stagnant tendencies is placed within the historical development of capitalism, and as the result of the process of concentration of capital throughout the Twentieth century. In particular, these theories emphasise the specific impact of market power – through markups – on the concentration of surplus relative to investment.

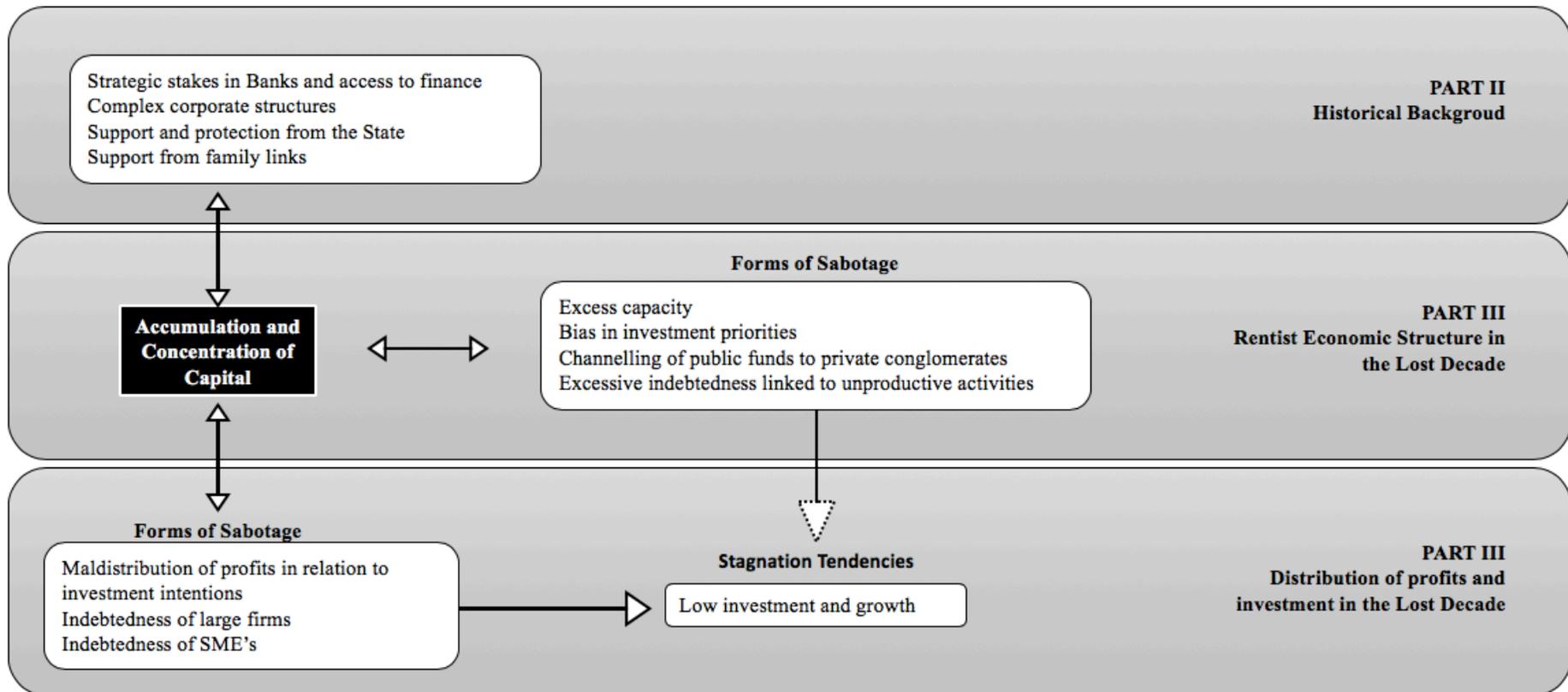
However, while markups are an expression of market power and effectively help its reproduction, they offer no explanation regarding the formation of that same power. The framework developed in this chapter deepens the analysis on the historical formation of market power – based on family networks, finance and the State – and relates it to the emergence of stagnant tendencies. The link between both realities is sabotage, understood as the growth damaging outcomes of the accumulation and concentration strategies of large capitalists.

This dissertation explores two perspectives on sabotage. The first considers the outcomes of an economy structured around the strategic and pecuniary interests of a rentist capitalist class. The second considers the distributive impacts of a dual non-financial corporate sector, marked by the existence of a few large powerful economic groups and a myriad of small and medium-sized enterprises.

It is argued, based on both these perspectives, that the process of accumulation and concentration of capital produced tendencies that are contrary to investment, employment and economic growth.

The role of the next chapters is to apply this rather generic framework to the Portuguese reality. The structure of these upcoming chapters, divided in two parts, and its integration with the existing framework is presented in Figure 12. Part II provides the historical background on the formation of large conglomerates, identifying the origins, beneficiaries, and strategies behind the process of concentration and accumulation of capital in Portugal from the beginning of the Twentieth century until the European integration process in 1986. The purpose of Part III is to show how sabotage – analysed from the two perspectives outlined – interfered with the structure of the economy to create the conditions for the Lost Decade, marked by low investment and indebtedness.

Figure 12 – Structure of empirical chapters



PART II: HISTORICAL BACKGROUND

5. From monarchy to the Carnation Revolution: the historical process of concentration and accumulation of capital through mixed conglomerates

5.1. Introduction

So far, theories of economic stagnation have been presented, with a suggestion that economic stagnation is due to a situation of underinvestment - a failure to invest on a sufficient scale – linked to the concentration of capital. In the following two chapters this process of accumulation and concentration of capital is documented for Portugal, since the beginning of the Nineteenth Century until the Carnation Revolution in 1974. During this period Portugal, lived under three different political regimes: the liberal monarchy (1820-1910), the First Republic (1910-1926) and the fascist dictatorship (1926-1974).

An original analysis of the evolution of the main banking and non-banking economic groups is proposed, focusing specifically on the three main elements that explain their advent and prosperity throughout the centuries: their family networks, their relationship with the State and their financial power.

Such interdisciplinary approach requires the analysis of economic, political and institutional variables. The role of the State and family networks will be reviewed, following Costa, Fazenda, Honório, Louçã & Rosas (2010), as new elements enter the analytical framework: acknowledging the structural importance of finance demands an understanding of specific links between banking and non-banking institutions, of corporate and ownership structures, and of balance sheet operations; the examination of power strategies of economic conglomerates implies a deep understanding of its motives, instruments and macroeconomic consequences.

There is no precise method for this type of critical historical investigation, as it requires a multitude of approaches, depending on the variable under consideration and the characteristics of the information available.

Section 5.2 explores the origins of the first fortunes in the Eighteenth and Nineteenth centuries, based on social and family connections, the relationship with the State and the right to explore colonial markets — in particular, the tobacco monopoly. Section 5.3 follows these fortunes through the First Republic into the first half of the dictatorship. It describes how the authoritarian fascist regime emerged as response to the aspirations of the existing bourgeoisie, whose composition, interests and motivations had not changed

in the past hundred years. In fact, until mid-Twentieth Century, the process of accumulation and concentration of capital in Portugal took place without any visible change in the productive structure. It was a process of unproductive accumulation centred around rentist activities, like finance, colonial trade and the exploitation of extensive rural properties. That situation changed in the second half of the dictatorship, addressed in section 5.4. Between 1950 and 1974, the industrialisation strategy put in place by the fascist regime involved the creation and development of an industrial capitalist class. This period marks the emergence of the Portuguese mixed conglomerates – large oligopolies that combined financial and non-financial activities – until the Revolution in 1974. Section 5.5 concludes, discussing the concrete forms assumed by the elements identified – family, finance and the State – and its contribution to the formation of specific accumulation regimes. It is argued that the industrialisation process occurred within the rentist strategy of the Portuguese bourgeoisie. It is also argued that this rentist structure – that opposed the centres of economic and financial power organised around banks to an insipid entrepreneurial landscape – is a key element to understand the characteristics of the Portuguese economy in the Lost Decade.

The analysis in this chapter is supported by the existing literature on Portuguese economic and business history, but also on original materials from primary sources.

Some works should be highlighted, as they serve as ground-base for the proposed investigation. Costa, Lains & Miranda (2011), Mateus (1998/2013) and Lains & Ferreira da Silva (2005) represent very extensive studies of the Portuguese economic history. Costa et al. (2011) provide an outline of the main characteristics of the Portuguese economy, from its constitution in 1143 to the years of European Monetary Integration. *Economia Portuguesa* (Mateus, 1998/2013) has been frequently used as a reference for graduate studies in economics. The book is mostly dedicated to the country's past and prospective macroeconomic evolution, in particular the determinants of economic growth. It is important to note that, in the second edition, Mateus introduced a new chapter, dedicated to the evolution of some economic groups. It is still a very incomplete analysis, covering only two case studies from before the Revolution and one from its aftermath. Nonetheless, it recognises the importance of business history to understand both the past and current economic structure.

Notwithstanding, most theoretical and empirical approaches to the Portuguese economy still ignore, on the one hand, the political nature of economic processes and, on the other,

the great influence exerted by powerful economic groups. This short review focuses on the exceptions to this evidence.

The most notable example is the book *Os Donos de Portugal* (Costa et al., 2010). It is a collective work on the evolution and characteristics of the capitalist class in Portugal, their family connections, internal disputes and political power, from 1910 to 2010. Its overall conclusion, that served as inspiration to the present chapter, is that the *donos de Portugal* [owners of Portugal], established and strengthened by the force of political and economic privileges, kept the economy in a state of underdevelopment. The content of this book served as guide and source of information for the current background analysis. The point of the present chapter is not to provide an alternative view of the same facts, but to gather new data from alternative sources of information, in order to contribute to a deeper understanding of the history of Portuguese economic groups and their strategies.

Still in the context of the evolution of main national corporations and conglomerates, two works are worth mentioning. The first is the study published by Maria Belmira Martins in 1973, describing the composition and business areas of the most relevant companies and groups in 1971. It is a very detailed and descriptive monograph, with valuable information to the historical reconstitution of these conglomerates. Rosa (2013) contributed to update and develop this perspective, providing a study of the concentration levels in the most relevant economic sectors in different historical periods. The book concludes for the dominance of economic groups and introduces a new relevant topic of discussion: the increasingly foreign ownership of the largest companies operating in the country. Costa & Mortágua (2015) examine the privatisation processes in Portugal, the evolution of the main privatised companies, and their performance under private management. Other relevant works covering specific historical topics, mostly published in *Análise Social*, will be mentioned throughout the chapter.

Although it could be said that business history is still underdeveloped as a methodological instrument in economic analysis, it is important to acknowledge the work that has already been published, also in its fragilities and incompleteness. Some of the works mentioned above were not created with an academic purpose or placed within a broader economic theory (Costa et al, 2010; Costa & Mortágua, 2015). Others cover specific historical periods (Martins, 1973), or focus more on the industries than in the specific accumulation strategies (Rosa, 2013).

Apart from the existing literature, the identification of the largest groups was based on monographs in economic and business history, company reports in the archives of the *Banco de Portugal* and newspapers. The reconstitution of corporate and financial structures and strategies also benefited from these materials, and was complemented by other primary sources from the archives of the *Banco de Portugal* and the Ministry of Finance. The most relevant aspects in terms of policy making come from the analysis of records of legislative and political debates as well as legal documents and other policy reports in the archives of the parliament, the *Assembleia da República*. The existing official statistics, from the archives of *Instituto Nacional de Estatística* – INE [Statistics Portugal], were also used for a broader contextualisation of the Portuguese economic structure.

These sources remain largely unused in economic studies and provide valuable information on the organisation and functioning of the Portuguese conglomerates. They are, however, very time consuming and carry important limitations in terms of systematisation and consistency. Accounting rules, when existed, were not standardised and the information in Annual Reports varies between companies and historical periods; official statistics were rare, the methodologies for data compilation and presentation varied and there is no integration in long-term series or conversion to digital formats. Finally, all these materials present year gaps, preventing year to year comparisons.

5.2. From 1820 to 1910: The Liberal Monarchy

The Nineteenth Century features the end of the old absolutist regime and its replacement by a free-trade liberal system, consolidated from 1851 onwards. The Napoleonic invasions motivated the flight of the royal family to Brazil. England's help was pivotal to put an end to the French occupation, and it largely determined the economic relations between the two countries for centuries. The unstable political situation led to the Liberal Revolution in 1820, followed by Brazil's unilateral declaration of independence. There were two sides of the liberal movement. Right-wing conservatives, the so called *Cartistas*, supported by the powerful bourgeoisie, were rather comfortable with the economic dependency from England, and had large speculative interests in finance, import-export and land ownership. On the left side, the small economic agrarian and industrial powers, represented by the *Setembristas*, advocated protectionist policies. The dispute between both sides culminated in a two-year civil war, in 1846-1847. The

following period, known as *Regeneração* [Regeneration], consolidated the victory of the *Cartistas* over the *Setembristas*. It is more or less consensual that ‘once power was seized by a landholding, banking and mercantilist oligarchy of barons and viscounts who wished political stability and freedom for financial speculation, the historical opportunity offered by the Regeneration — of an autonomous economic policy, capable of influencing the establishment of an effective national independency — was lost.’⁴⁹ (Serrão & Martins, 1978, p. 47)

The Regeneration period confirmed and deepened the approximation between large capitalists and the nobility. They came together in a symbiotic relation: capital in exchange for titles and privileges — not only social privileges, but also, and more importantly, the legitimate right and opportunity to accumulate.

Pedreira (1992) describes some of the patterns of business success in the Eighteenth Century. Although some of these fortunes had humble origins (mostly sons of farmers or craftsmen with some money), the big jump to financial power was only possible with State’s help: ‘It is true that great magnates prosper in their relation with the State, or under its protection. The tobacco deal performed a fundamental role in structuring such plutocracy.’ (Pedreira, 1992, p.435)

José Estevão, a member of parliament representing the radical branch of *Setembristas*, once said that ‘it was rare to find a great fortune in the country that has not been part of the tobacco contract’ (in Mónica, 1992, p.462). Since the Eighteenth Century the contract was given to a small number of families. Some of them, like the Mello family, are associated to the great fortunes that made it to the Twentieth Century.

During the first half of the Nineteenth Century, constant political conflicts and the loss of the monopoly over the Brazilian market, among other factors, caused heavy fragilities in public accounts. These constant deficits were mostly financed either by direct loans or the issuance of debt titles. Either ways, the banking sector enjoyed great power, chiefly because financial support was frequently recompensed with authorisations for printing bank notes. It was a fine context for the development of the banking system. In 1821, the *Banco de Lisboa* was formed. It was the first bank operating in the country and issuing bank notes. Its main shareholder was Henrique Teixeira de Sampaio, already the largest

⁴⁹ In this dissertation I have translated all quotations from Portuguese to English.

State creditor.⁵⁰ After 1835, other banks were formed, especially in the north, namely *Banco Comercial do Porto*, *Banco Aliança*, *Banco Comercial de Braga*, *Banco União do Porto* and *Banco do Minho*. In 1846, Bank of Lisbon merged *Companhia Confiança Nacional*⁵¹, founding *Banco de Portugal*, the State's main financier.

The adoption of the gold standard and free trade policies were part of the new political programme. In 1864, two new banks were formed. *Banco Nacional Ultramarino* was created in order to become the issuing bank in the colonies, and *Companhia Geral do Crédito Predial* was focused on mortgage loans. More importantly, a new law on public companies liberalised the constitution of corporations, eliminating the need for previous state authorisation. These reforms were responsible for a steady rise in importance of financial and banking activities, that culminated with the establishment of state owned *Caixa Geral de Depósitos* (CGD) in 1876.

Due to political pressures, the tobacco monopoly was dismantled in the 1860s. The market was divided between old contractors and a small number of new companies⁵². By 1881, the industrial census showed that some of the small tobacco factories no longer existed, and the sector went through a process of concentration. The three largest companies – *Companhia do Tabaco e do Sabão da Boa Vista*, *Companhia da Fábrica de Tabacos de Xabregas* and *Companhia Lisbonense de Tabacos* – formed *Companhia Nacional de Tabacos*. It employed more than 2/3 of the total workforce in the sector alone. In 1883, the private monopoly imposed a price agreement to its smallest competitors, increasing its power even further. By 1887, there were only four companies left.

In 1887, after the *Companhia* refused to pay higher taxes, the sector was nationalised and the previous system of concessions reinstated. In 1889, a new financial crisis came to determine the future holder of the tobacco concession. The State's main financing bank overseas – the Baring Brothers – had a large overexposure to Argentinian and Uruguayan debt, and both countries were near to financial collapse. Count Henry Burnay saw a chance to lead a coalition to grab the tobacco monopoly and agreed to intermediate a loan

⁵⁰ Son of a tradesman with good political connections, who became made a fortune in the export-import sector with England. Henrique Teixeira Sampaio first became the main supplier of the State army and then the lucky holder of the tobacco contract. He was later the member of the government responsible for financial and tax policies.

⁵¹ Created in 1944 as part of the deal to obtain the concession of the tobacco and soaps monopoly.

⁵² *Companhia de Tabaco e Sabão da Boa Vista*, *Companhia da Fábrica de Tabacos de Xabregas*, *Companhia Lisbonense de Tabaco*, *Centeno*, *Barreiras de Xabregas*, *Lusitânia*, and *peninsular*.

in exchange for it. The contract was signed in 1891 and granted the Count control over the tobacco sector for 35 years.

Apart from tobacco concessions, the *Regeneração* consolidated old fortunes and created new ones. By the end of the Nineteenth Century, the Portuguese bourgeoisie was divided in two groups:

‘great businessman and financiers who, amongst other investments, had placed their capital in factories; and individuals whose existence depended exclusively on profits obtained in the industrial sector. The first belonged to the great bourgeoisie, who socialised with landowners, diplomats, politicians and high officials. The second were modest people, without access to political power and limited in their social relations.’ (Mónica, 1987, p.853)

In the north, more precisely in Oporto, this large bourgeoisie was concentrated in two sectors: wine and textiles. In Lisbon, we find those businessmen connected to import-export or financial activities. They owned large oligopolistic factories.⁵³

The traditional wine sector developed under the dependency of England and trade agreements from the 18th Century which secured Portuguese imports of British textiles in exchange for a market for Portuguese wines.

The textile sector, on the other hand, grew dazzlingly, making extraordinary profits, in the last decades of the *Regeneração*. The success can be explained by a combination of two factors: the long awaited protective tariffs and the opening of African colonial markets (Mendes, 1980).

Such protectionist policies came to be highly criticised — not so much by its existence in principle, but by its discretionary nature:

‘As in the agricultural sector, industrial protectionism not only failed to promote the expansion of the Portuguese manufacturing sector, but also seems to have been responsible for an industrial structure disconnected from the potentialities of the Portuguese secondary sector.’ (Costa et al, 2011, p. 337)

⁵³ In 1881 78% of the industrial working force was employed in 70 corporations (Monica, 1987).

A renewed interest in Africa was the solution for the crisis of the 1890s. Besides the slave trade, which was the source of important fortunes⁵⁴, the crisis opened new lines for business and fortune, namely in the transport and infrastructure sectors.⁵⁵

Apart from textiles — especially cotton —, the fertiliser sector also flourished under the protection of trade rules. It was almost inexistent before the end of the century, and it grew under the control of Alfredo da Silva's⁵⁶ *Aliança Fabril*. *Aliança's* main activity was the production of soaps, a previous monopoly controlled by the state. Soaps residual oils were used to make fertilisers. At the time, Burnay was the owner of one of the few chemical companies in the country, *União Fabril*, and also had a share in *Aliança Fabril*. It was not surprising that, in 1898, Alfredo da Silva and Burnay decided to merge *União Fabril* with *Aliança Fabril*, creating the largest and probably most important industrial group in Portuguese history: *Companhia União Fabril* (CUF).

CUF diversified its activities: fertilisers, chemicals, and even sacks, buying *Companhia de Tecidos Aliança* from Burnay's firm (Rollo, 2008). In 1911, Burnay sold his share to Alfredo da Silva, who became the sole owner of CUF.

The metalworking sector was almost inexistent, apart from one company belonging to Burnay. In the glass sector, the state owned *Real Fábrica de Vidros*, but it would also end up in the hands of Burnay. In ceramics, the most important company belonged to the family Pinto Basto, whose fortune derived from the wine and agriculture sectors, as well as from the tobacco contracts.

In sum, close to the turn of the century, the bourgeoisie had grown in number, power and fortune. Financial power was now in command and expanded to those sectors in which the State could guarantee large rents without competition. Together with tobacco, the cotton industry emerges as the centre of the accumulation strategy.

There are important conclusions to highlight in this preliminary historical contextualisation.

⁵⁴ Namely the FONSECAS family, owner of *Banco FONSECAS & VIANA* (later *Banco FONSECAS & BURNAY*) and of the tobacco monopoly (Caldeira, 2013).

⁵⁵ The National Navigation Company [*Companhia Nacional de Navegação*] was formed in 1881, with capital from the Bensaude Group, that negotiated with the state a regular line between Portugal and its colonies. The Pinto Basto Group, on the other hand, earned the right to intermediate a regular line with Mozambique (Costa et al, 2010 p.27).

⁵⁶ Born in 1871, son of a rich family with vast interests and holdings, from real estate to lands and shares of the largest companies in the country. Among those companies *Banco Lusitano*, creditor of two industrial companies: *Companhia União Fabril* and *Companhia Aliança Fabril*. By converting the loans in shares, and merging the two companies, Alfredo da Silva created CUF (Valério, Nunes Bastien & Costa, 2010)

As the XX Century approached, Portugal remained an underdeveloped country. While in the centre of Europe the second industrial revolution was already in place, Portugal was increasing its economic divergence. The Portuguese GDP per capita in 1820 was the equivalent to 63,9% of the European one and, in 1913, that value was 40,2%. The industrial census of 1912 reveals an industrial structure generally suffering from the same weaknesses of the previous decades. Manufacturing accounted for 13% of total exports, mainly directed to England, Brazil and the Colonies. Almost half of the industrial labour force was employed in the textiles and footwear sectors, that accounted for 45% of manufacturing exports. The remaining workers were divided between the food and tobacco sector (15%), wood and cork (12%), chemicals (10%) and metalworking (9%). The industrial share of the output was only 27,1% in 1910, while agriculture represented 37,1% (Mateus, 1998/2013).

The industrial landscape combined three realities: a disperse group of small workshops and industries, operating rudimentary methods and with no access to capital or financing; a small group of strong economic groups, mostly with connections to finance, operating in sectors highly protected by the state; and a group of foreign technological companies, not surveyed in this analysis, exploring the communications, energy and transport sectors. This business structure persisted throughout the Twentieth Century.

5.3. From 1910 to 1950: unproductive accumulation under the fascist dictatorship

The period between 1910 and 1929 was unstable, marked by the disintegration of the political and party system. The 1910 Regicide was no surprise, given the crisis the regime was going through. Still, the First Republic was unable to provide answers to the most important social problems. The Republican system inherited the existing public debt, increased by the Great War efforts. Besides inflationary pressures and economic distress, the situation of permanent political instability created the grounds for a conservative military coup in 1929.

The fascist tendencies that inspired the coup configured the material answer to the aspirations of the bourgeoisie, unhappy with the direction taken by the Liberal Regime. The growing instability and free trade orientation no longer met their accumulation strategies. The oligopolistic powers asked instead for a strong State, an authoritarian government to defend colonial markets – crucial outlets to absorb the production in excess

and to provide cheap raw materials –, discipline the competition, protect profit rates and control the aspirations of a still incipient industrial working force.

Maria Filomena Mónica describes the establishment of a ‘State patriciate, based on internal monopolies, captive colonial markets, customs protectionism and a political force capable of guarantying a cheap labour force ... the interpenetration between the State and the economic groups increased. Access to the political power which decided important matters, such as who could build a factory, import raw materials or export products, became decisive.’ (Mónica, 1990, p.22)

This process did not happen without contradictions, namely between the two main economic forces supporting the new regime – agrarian powers and industrial elites –, but also between them and the powerful import-export groups, connected to the banking system. In part, the extensive public intervention in the economic organisation had the purpose to mediate these conflicts.

By the 1930s, the main pillars of the new economic model within Estado Novo became clear: fiscal stability, economic self-sufficiency, protection of national industries and colonial trade, plus social stability. The State supervised the system, suppressed competition, controlled the working class, guaranteed the access to financial support and provided the infrastructures.

The development of the industrial sector — weak, dependent on sporadic external opportunities and dominated by small and decapitalised companies – became a priority in the first half of the dictatorship. To do so, the State protected those groups that constituted, at the time, an exception to the pulverised industrial landscape, and allowed others to appear and develop.

During this period, the economic oligarchy was concentrated in three main sectors: landlords, bankers connected to import-export business, and industrials.

The structure of the agricultural sector did not change much during the first half of the fascist regime. In 1950, only 0,4% properties reported more than 100ha; however, these properties, located mainly in the centre and southern regions, represented 45% of the total land in the country (Freitas, Almeida & Cabral, 1976, p.76). The land oligopoly was in the hands of a few landlords, known as the ‘cereal lobby’, in the south, who demanded controlled prices and protective tariffs. In the North, where production was more diversified, there were also some influential landowners with great political power.

Amongst the most powerful were the wine producers. Overall, both the wine and cereal interests opposed to any attempt to implement a much-needed agrarian reform, the only way to modernise production and free the labour force to feed the developing industry (Pereira, 1980).

The import-export sector, with deep connections to the banking sector, focused on economic relations with England and on colonial trade. This sector was dominated by a small number of large companies.

In first years of the 1930s, there was a new attempt to control and stabilise the banking sector, dominated by four private banks: *Banco Espírito Santo* (BES), *Banco Lisboa e Açores* (BLA), *Banco Burnay* (BB) and *Banco Pinto e Sotto Mayor* (BPSM).

These four main banks represented 25,8% of total financial investment and 33,8% of the national securities portfolio. The state-owned *Caixa Geral de Depósitos* (CGD), with its two subsidiaries, *Caixa Nacional de Crédito* and *Caixa Nacional de Providência*, was also one of the most important institutions in the system (Reis, 1987, p.256).

Finally, the third group comprised the captains of industry. Some of these capitalists came from the banking/import-export area, others were the heirs of the Nineteenth Century fortunes, in particular the tobacco monopoly.

The most concentrated sectors were in basic manufacturing industries: cements, tobacco, sugar, matches and chemical fertilisers.

In the 1920s, CUF was already the largest industrial conglomerate in the country. In 1919, Alfredo da Silva created *Sociedade Geral de Comércio, Indústria e Transportes, Lda* with the aim of concentrating all shares in non-industrial activities, especially commerce, to explore colonial trade lines. It was through this company that the group joined the banking sector, buying *Casa Henriques Totta e C.^a* in 1921.

Alfredo da Silva secured the State's protection from foreign competition in key activities from the beginning (Rollo, 2008). In 1927, the regime authorised him to create *Tabaqueira*, in the tobacco industry. After the end of the State concession in 1926, the previous holders of the contract – the Burnay family and Ulrich families and *Banco Fonecas & Viana* – maintained control over the most important corporation, the *Companhia Portuguesa de Tabaco*. However, having invested more in modernising its production, *Tabaqueira* ended up controlling the market, bringing the Burnay empire to

an end, as well as his alliance with Alfredo da Silva. In 1939, the tobacco sector comprised eight companies, employing 2.345 workers (*Estatísticas das Sociedades*, 1939).

In 1936, CUF obtained a new authorisation, this time to exploit the Lisbon shipyard, thus entering the naval construction sector. In 1942, its first insurance company, *Império*, was founded.

The cement sector was dominated by two companies: Secil, created in 1925 by the absorption of *Companhia Portuguesa de Cimentos*, property of Belgian and Danish capitals; and *Companhia de Cimentos de Leiria* (Maceira-LIZ), created in 1923 and controlled by the Sommer family. In 1944, after the death of Henrique Sommer, his nephew, António Champalimaud, assumed the control of the cement's empire, in dispute with the remaining heirs. In that same year, Champalimaud married Cristina de Mello, the granddaughter of Alfredo da Silva. Champalimaud became CEO of *Sociedade Geral*. Using the political influence of Alfredo da Silva and financing from *Casa Totta* (CUF's bank), *Caixa Geral de Depósitos* and *Banco Nacional Ultramarino*, Champalimaud expanded his control in the cement sector, installing several companies in the African colonies (Costa et al., 2010).

Two companies controlled the fuel sector: SONAP and SACOR. SONAP (*Sociedade Nacional de Petróleos*) was created in 1934 as a distribution company, property of Manuel Queiroz Pereira (20%)⁵⁷, Manuel Baullosa (20%), and French capitals (60%).⁵⁸ In 1936 and 1937 the government put in place a new reformist agenda, which included the creation of an oil refinery. SACOR emerged as a joint venture between the State (33,34%), the Romanian company Redeventza (40,28%) and *Banco Espírito Santo* (BES), owned by the Espírito Santo family (8%). The company enjoyed large tax and legal benefits, besides the monopoly over the refining activity and half the fuel market. In 1940 SACOR created CIDLA (owning a participation of 51%), which kept the monopoly of the urban gas sector until the 1960s.

All in all, despite the State's initiative to promote concentration, the development of manufacturing industries remained low, especially when compared to the financial sector. The two main pressure groups were still absentee landowners and a powerful coalition between banks and colonial trade. In the 1930s, productive capital was a minor force in

⁵⁷ Manuel Queiroz Pereira Carlos Pereira was already related to *Banco Comercial de Lisboa*, which would be merged with Banco Espírito Santo in 1937, creating the BESCL.

⁵⁸ In 1934 SONAP bought two other competitors in the market: Radiante S.A.R.L and Radiante, Lda (Santos, 2011).

the economy. CUF was the exception, as it emerged as the first mixed conglomerate, with a strong presence in all relevant economic sectors, from banking to heavy industry.

The consequence was the technological and productive backwardness of the country:

‘It was like a vicious cycle: the country was kept poor and the national market narrow and unattractive because wealth holders invested little in the modernisation of its production apparatus; and the wealthier ones did not apply their capital in the national economy because it was backward and the investment was risky and little rewarding in relation to the income offered by exporting capital ... [t]heir [the banking and trade capital] biggest resistance weapon [to the threat of importing substitution industries] – besides the persistent political opposition to economic reformism – was non-investment, either by hoarding or flight to foreign markets.’ (Costa et al., 2010, p. 103)

The Second World War had mixed impacts on the Portuguese economy. After three years of economic growth (1939-1941), the economy started declining. As the balance of payments benefited from the Portuguese neutral position in the conflict, the excess money supply led to inflation that added to the already increased price of imports.

The financial sector was without doubt the most favoured in this period, for several reasons. First, capital inflows, whether from trading activities or simply financial funds in search for a safe and stable country in Europe, inflated banks balances. Secondly, banks guaranteed commercial operations for both sides of the conflict — Germany and the Allies, namely England. Thirdly, in order to control inflation and absorb the excessive money supply, the State proceeded with a policy of debt issuing to finance new industrial projects.

This period of financial prosperity translated into the growth of the banking sector, in terms of the value of its assets, number of institutions and consolidation of existing banks.⁵⁹ *Banco Borges e Irmão* (BBI) was created in 1937 and *Banco Português do Atlântico* (BPA) in 1942. *Banco Nacional Ultramarino* (BNU) was nationalised after the crisis of 1929 and, as a public bank, became one of the most important banks in the country.

Trade activities continued to absorb more than half of the total credit. But that does not mean that there were no intersections between the industrial and financial sectors. Starting in the 1940s, the banking sector expanded its balance sheet, increasing the value and

⁵⁹ *Banco Espírito Santo* (BES) absorbed *Banco Comercial de Lisboa* in 1939 and became *Banco Espírito Santo e Comercial de Lisboa* (BESCL).

number of participations in non-financial corporations. That evolution, which started with colonial and agriculture related activities, moved, in the 1950's, into the industrial sector.

The effects of the Second World War on the industrial sectors are not as clear. While some industries, linked to the colonial trade or black markets, were favoured, others, more dependent on intermediate goods, suffered with the increase in international prices. In general, until end of the conflict, the capitalist accumulation proceeded without investment or industrial modernisation.

The widespread misery caused by the war context placed the regime, for the first time, in a fragile situation. On top of its concerns was the need to control prices, to guarantee the supply of basic goods, to suppress the black market and to develop the industry. Therefore, the State entered a new stage of pro-industrial policies, in spite of the still powerful colonial and agrarian lobbies.

This new strategy had three main pillars: i) tight control over all aspects of the production process, from the number of licensed industries to their market prices; ii) development of basic infrastructures, from electricity to transports; iii) introduction of heavy industries.

The first step of the new strategy was taken as soon as 1945, with the Law 2.005 establishing the means and forms to stimulate and control the industry. Therein, the government determined the creation of new industries, promoted and financed by the State — directly or through its banking institutions — in cooperation with the private sector, and ensured the reorganisation of the already existing ones (*Diário do Governo*, 1945). In 1947, a new law was published, concerning the industrial controlling policy (Industrial Conditioning [*Condicionamento Industrial*]) specifically. It is consensual that, as argued by Confraria (1991), the control of the regime over the industrial production contributed decisively to administratively create and maintain monopolistic structures. The political conflict between industrialist and agrarians over protective economic laws lasted for years and it is carefully described in Caeiro (2004).

At the heart of the new legislation was the idea that concentration was a key aspect to promote the necessary industrialisation of the country. It is interesting to note that, in the process of discussion at the *Assembleia Nacional*, the most prevalent concern over the new law was precisely the consequences of such a process of capitalist concentration. The agrarian lobby worried about the political creation of a group of industrial captains, capable of threatening the existing social order (Caeiro, 2004, p.131).

Between 1940 and 1947, 6.737 new businesses were created, mostly as private limited companies (*Estatísticas das Sociedades*, INE). However, the concentration of capital in large public companies increased substantially. Besides the financial sector, most of this growth happened in the manufacturing sector.

5.4. From 1950 to 1974: the great accumulation under the fascist dictatorship

5.4.1. Concentration policies

The 1933 Constitution established the main principles of the new economic model: State intervention, corporatist organisation and economic nationalism. In practise, this strategy was translated into two groups of policies: competition restriction policies and economic planning policies.

The main purpose of the first group was to substitute the market mechanisms of economic regulation and organisation for a corporatist regime, operating under governmental scrutiny and discipline. The corporatist part of the system, understood as the free coordination of economic agents, never became a reality. Instead, the State used the regime of industrial conditioning to control production, by deciding who could produce and how. Furthermore, the system of administrative prices or customs protection determined, or at least influenced, the firms' costs and revenues structure.

The first *Lei do Condicionamento Industrial* [Law of Industrial Conditioning] was published in 1931 as a temporary measure to ease the negative effects of the Great Depression. In general terms, its purpose was to avoid a crisis of excess capacity and supply by limiting predatory competition in the market. From that moment on, the State had the power to authorise any request for substantial investment projects resulting in additional capacity or producers. It could also determine the foreclosing and/or concentration of companies in more dispersed or less technology intensive sectors/firms.

The industrial conditioning policy lasted until the end of the dictatorship and was responsible for the establishment and perpetuance of large oligopolistic sectors, dominated by a few protected economic groups.⁶⁰ The law was changed in 1952 and 1965, and its scope of application was reduced as its criticism increased.⁶¹ Nevertheless, in the 1970s, half of the employment in manufacturing industries was still attributed to

⁶⁰ See also Lains (1994, 2003) and Confaria (1991) for a detailed analysis of this industrial conditioning policy.

⁶¹ Law 2052, 11th March and Decree-law 46666, 24th December.

companies operating under the conditioning rules. Furthermore, it was common for the State to coordinate large investments between the oligopolistic groups, and to decide new entries based on projects presented by the existing companies.

Given the private resistance to forced concentration, industrial conditioning policies ended up being directed to controlling incremental investments. The pre-existing inefficient structures were maintained, and the bureaucratic decisions concerned the installed capacity mostly (Confraria, 2005, p.401).

Finally, in those sectors where the competitive structure was dominant, like the textiles or the food industries, the State intervention aimed mainly at the promotion of the largest units in detriment of the smallest.

The priority given to industrialisation was deeply connected to the notion of economic nationalism. In this aspect, the system of customs tariffs was an extension of the First Republic's trade protectionism, adapted to a new strategy of import substitution and development of basic industries. The choice of protected sectors was subject to heavy criticism. In the late 1960s, with the beginning of the new phase of greater international openness and integration, this protective structure started to change.

Nevertheless, despite the pressure to curtail the limits to competition – either via less tariff protectionism or a scaled-down application of industrial conditioning from the mid-60s onwards –, it did not change during this period. (Nunes, 2002, p. 15)

Confraria (2005) argues that the protective policies might have had some positive results, such as regulating excess capacity, improving production efficiency or even promoting Portuguese exports. However, at a certain point, the artificial maintenance of ineffective structures pushed the economy in the opposite direction.

This economic strategy was complemented by other elements. To begin with, price controls were put in place for some key agricultural products, in order to supply the industry at low cost. Secondly, colonial markets were a source of cheap imports of raw materials and an outlet for excessive production. In third place, a policy of low wages and limitation of labour rights was implemented. Finally, legislation that demanded a minimum stake of 60% Portuguese capital in key sectors favoured the expansion of national economic groups.⁶² Around the 1970s these limitations were relaxed, as

⁶² Lei de Nacionalização de Capitais, Law 1994, April 1943.

participation of foreign capital in more technology-intensive sectors increased, mostly directed towards exporting markets.

The government's direct contribution to investment was always marginal (under 3% of GDP). The first experiences of State ownership in the industrial sector were made in the 1960s. However, between 1950 and 1974, the State's economic vision was translated into five-year plans, under the name of *Planos de Fomento*. Its implementation was coordinated with the largest economic groups and financed by the State and commercial banks.

The first plan (1953-1958) accounted for 14% of the total gross fixed capital formation and was mostly directed towards building basic infrastructures (transports, electricity and communications). The second plan (1959-1964) prioritised infrastructures but increased the relative importance of basic industries (metalworking, fuel, fertilisers and paper). *Plano Intercalar* (1965-1967) represented almost half of the national fixed investment in this period, and introduced new priorities: housing, urban services and health care. The third plan (1968-1973) maintained the industrial and social focus and reflected the growing criticism of competition restriction policies.⁶³

The Colonial War signed the beginning of the most authoritarian and repressive phase of the dictatorship, but also of its economic opening. It was under this new stage that the Portuguese government negotiated its participation in EFTA and GATT agreements. Finding an outlet to growing production was one of the arguments influencing this decision. At the time, the debate was centred around the need to prepare the economy to compete with foreign companies in key sectors, previously protected. Lains (2003) summarises these debates in the following way:

'In general terms, the model that was criticised was the one of industrialisation based on low wages in industry, only possible due to what these authors thought to be an artificial maintenance of a low cost life, the outcome of low prices in national agriculture ... No one contested the State involvement in economy and, in particular, in industry ... Mainly from the end of the 1960s on, some people started to question the effects of economic policy as far as the allocation of national income and the wealth of the industrials who benefited from State protection were concerned.' (Lains, 2003, pp.180-181)

⁶³ See Table Ap.1 in the Appendix for details on these investment plans.

There were promises of a new liberal economic strategy, capable of introducing elements of competition in the industrial structure, to foster Portuguese exports to other markets, and to open the national borders to industrial multinationals. However, even though the authors of the new strategy openly criticised the previous model of protection and privileges, it was widely assumed that the modernisation of prioritised sectors (heavy industries, manufacturing and construction) was only possible through the concentration of capital in large private economic groups.

These were the main ideas behind the New Industrial Strategy that formed the Fourth *Plano de Fomento*, published in 1972. In it there was an explicit criticism of the previous policy of industrial conditioning, responsible for holding back modernising forces, upholding its replacement by a system of incentives directed by the State. The impetus of the 1960s seemed to have faded away, and the liberal wing claimed for new industrialising efforts. In 1970, Rogério Martins, Secretary of Industry, published *Caminhos de País Novo* (Martins, 1970), advocating:

‘To replace the verb to condition with the verb to promote; to replace the idea that public power grants benefits and privileges with the idea that it helps entrepreneurs to be successful in the world of objective laws of economic strife; to make it clear that we cannot, on the grounds of protecting industry, support stifling monopolies of valuable initiatives...’ (pp.25-26)

It took two years to create the regulatory framework for the New Industrial Policy. The delay in implementing the new strategy was due to different lobbies pushing in different directions, mostly trying to avoid any movement that could put their position in jeopardy.

5.4.2. Financing constraints and strategies

Both private and state-owned banks were key elements in financing investment. Public development institutions were mainly financed by the issuance of medium and long-term bonds, placed in private banks. The financing of public activities was, therefore, one of the banks’ most lucrative and safe activities.

Besides financing of large (public) projects, the financing relation between the banking and industrial sectors was mainly operated through short-term loans. Medium and long-term loans were rare.

For banks, short-term operations granted the necessary flexibility to meet the solvency and liquidity ratios, but were also a protection against inflation. On the side of the firms,

having to pay longer term loans in full by the maturity date represented a serious constraint. For firms and banks alike, renewable short-term operations, such as the continuous rollover of overdraft accounts, were the preferred solution, given the existing alternatives. Several schemes were employed to avoid legal ceilings on short-term interest rates.

Furthermore, the banks' preference for collateral, usually in the form of fixed assets, in detriment of the project's profitability, created a bias towards the largest firms. The market for bonds was practically inexistent. Only public companies could issue such titles, their rate had a fixed ceiling and the lack of flexible options (such as convertible bonds or mechanisms to ensure its liquidity in the secondary markets) rendered them too sensitive to inflation. On the other hand, stock markets were mostly used for speculative purposes, not as an instrument to raise capital.

The speculative tendencies in the stock market resulted from a combination of factors. First of all, the low interest rates policy implemented by the government made alternative debt operations less competitive. Secondly, the banking sector expanded impressively in the beginning of the 1970s, with corresponding increases in the availability of liquid assets looking for an outlet. Finally, the supply of public offerings relatively to the demand for new stocks was somewhat short. Despite the process of increased concentration through mergers and acquisitions in the early 1970s, the concerns of the main economic groups over the effective control of their capital (kept within the family structure) limited the amount of new stock issues.

Larger companies and economic groups could bypass the financing constraints described above for three reasons: they could access and control both the banking and the capital markets; they mobilised their reputation and political influence; they used their capacity to accumulate internal funds. Self-financing served considerably more than half the investment activity.⁶⁴ Nevertheless, the financing problem was pointed out as one of the most important constraints to the accumulation of physical capital, and one of the reasons behind the slowdown in investment rates in 1967 and 1968.

The underdevelopment of the Portuguese capital market was central in the argument outlined by large private businesses to back their claims and support their interests. This

⁶⁴ See Forjaz & Mateus (1968).

being so, they demanded low taxes on profits, so to protect firm's internal saving capacity, as opposed to the forced saving by the state⁶⁵, as well as public support for large industrial projects and freedom to operate a strong process of capital concentration without competition.

These three ideas were explicitly formulated by António Champalimaud in 1958, in his comments to the second *Plano de Fomento*:

'It is undeniable that in this country there is not – and that will be so for a long time – a capital market capable of satisfying the needs of the industry ... Therefore, self-funding plays a main, essential role in companies' life and growth, mainly medium-sized ones. For the big ones – generally covered by the *Plano de Fomento* –, the recourses of the treasury, the welfare and the public are generally used.

Therefore, references that, in practical terms, lead to severe tax measures or overstated limitation of profit concern entrepreneurs ...

There are many allusions to certain types of economic organisation of production, using forms such as “conformation of power”, “monopoly” and “oligopoly”.

What really matters is ... to measure industry on a scale that may allow a future halt in ... the invasion that the German cartel industry will fatally try, even in small factories.

How bad is it for this country to find in an active facility in Alhandra a kiln which, being the largest in the world ..., would by far exceed the minimum established to the industry?

It will add – at least one should rely on it – power to the one the company may already have, but this added power could never be given to the Nation, except for the capacity of those who have already ceased to be small, often thanks to great sacrifices of turn on capital, not to speak of others.

We should not ignore the tugging effect of the appearance of one or a few more important industrial groups on the Portuguese industry. Do we have, in this country, new industrial drivers of industrialisation capable of generating the same effects? Are they ready to act efficiently?

The truth is that this country cannot do without the technical and administrative potential that only the coalition can create. If it does so, the economy will be harmed.

Lastly, it should be noted that in developed economies, both those often subject to socialist governments (Belgium, for example) and liberal ones

⁶⁵ According to Teixeira (1991), there was no real capacity to tax large corporations, mostly because their accounts were not trustworthy.

(such as Germany), economic development is based on large organisations and industrial coalitions (favoured by the State).’ (*Opiniões da Câmara Corporativa*, 1958, pp. 762-767)

This statement could not be any clearer regarding the key elements in the organisation of economic power, nor on the importance of the oligopolistic bourgeoisie. Champalimaud speaks on behalf of small and medium businesses in order to protect his own profits, and in the name of the nation’s best interest to defend his monopolistic position. At the same time, he provides a lucid picture of the prevailing duality in the Portuguese economy: on the one side, small and medium-sized enterprises, dependent on the accumulation of profits and short-term credit; on the other, large groups structurally dependent on the State to finance large industrial undertakings.

This financing was supplied mostly by *Caixa Geral de Depósitos* and its subsidiary, *Caixa Nacional de Crédito*, as well as *Banco de Fomento Nacional* (created in 1958). However, as will be described next, the large private industrial groups also made a strategic option for the acquisition of important stakes in the banking sector.

The process of stock market inflation in this period also had consequences for the large conglomerates’ financial capacity. It led to the revaluation of balance sheets, freeing capital to invest in new companies and sectors. It also increased holding companies’ capacity to obtain new loans, or to issue new debt. It provided important financial gains that complemented operational results in periods of economic distress and helped masking situations of undercapitalisation, mostly in the largest groups.

5.4.3. Groups with industrial origins

According to *Estatísticas das Sociedades*, published by INE, in 1940, 490 public companies represented 4% of total businesses but were responsible for 50% of the existing capital. In 1950, 583 public companies, representing 3% of the total number of businesses, held 58% of total capital. Ten years later, in 1960, 678 public companies were 2,5% of the total and concentrated 67,9% of the capital.

Despite minor changes, around 90% companies held around 10% of total capital in the economy. Only 0,1% (corresponding to 19, 32, 55 and 70 companies in 1954, 1960, 1965

and 1970 respectively) accumulated around 45% of the total capital. Medium-large companies were 1% of the total number of firms and held around 17% of total capital.⁶⁶

The evolution of large industrial conglomerates was structurally connected to the State's economic intervention. With national economic self-sufficiency in mind, attention focused on three activities: hydroelectricity, chemical fertilisers, and the steel industry.

Generally speaking, these investments were mainly financed by the public sector, either through long-term loans provided by *Caixa Geral de Depósitos* and *Banco de Fomento*, or by issuing shares and bonds which were bought by social security funds. Other private agents, mostly banks, held minor but highly lucrative financial participations in electric companies. In general, as mentioned by Ribeiro, Fernandes & Ramos (1987, p.954) the amount of investment out of internal funds was small in these companies and, as a consequence, dividends were substantial, mostly in rentist sectors – utilities and activities related to colonial markets.

Table 2 - Dividend Yield 1972

	n. companies	DY
Banks	8	0,84
Electricity, Gas, Water	7	4
Diverse	23	2,11
Colonies	12	5,24

Source: Forjaz & Mateus (1968).

The two main private industrial groups were the CUF Group (also known as Mello Group) and the Champalimaud Group. The State was the third piece in the Portuguese industrial puzzle, with a direct presence in key sectors, like SACOR, the oil refining monopoly, and

⁶⁶ It should be noted that these statistics report the number of societies according to their capital, making no distinction or reference to their property structure. This means that it is very likely that most of these large and medium-large companies belonged to the same groups. In that case, the process of accumulation depicted in the graphs below might be highly underestimated.

Amoníaco Português – in a situation of duopoly in the chemicals sector (together with CUF).

The fuel refining business was dominated by SACOR. During the 1950s the company expanded its activity to the production of gas, as well as fertilisers and pesticides, penetrating an area typically dominated by CUF. In 1957, SACOR created *Sociedade Portuguesa de Petroquímica* — together with CRGE — and *Nitratos de Portugal* — together with SAPEC and *Amoníaco Português*. In 1959, SACOR also established its own navy company – SACOR-MARITIMA.

Amoníaco Português was already one of the two most important companies in the fertilisers sector. The other was *União Fabril do Azoto* (UFA), owned by CUF. In 1959 UFA bought a share in *Sociedade Portuguesa de Petroquímica* (owned by SACOR) and obtained a license to produce ammonia from fuel. The market was then split between the two companies: *Sociedade Portuguesa de Petroquímica* (now CUF) and *Nitratos de Portugal* (SACOR).

One of CUF's most emblematic areas of expansion was naval construction, Lisnave in particular. The construction of a shipyard in the Lisbon area was decided, by law, in 1960 and assigned to CUF, already the owner of Navalís. It started labouring in 1967, when Portugal regained importance in maritime routes after the closing of the Suez Canal. Lisnave became a relevant international player, as it grew in capacity to remodel large ships. Soon the CUF group created other companies to support its naval construction activity: services (Gaslimpo), electronic equipment (ENI), propeller components (Repropel). Ribeiro et al (1987) note that the development of Lisnave broke with the traditional format of Portuguese industries, exclusively protected by the State and dependent on national and colonial markets.

Around 1965, CUF became a holding company, turning its industrial support departments into autonomous companies dedicated to providing all kinds of services. In 1966, the group consolidated its outstanding liabilities, issuing a new series of bonds, proving its privileged access to financial markets (Annual Accounts, 1966, 1967).

It was also around 1965 that the rapid growth in the consumption of refined fuel products led the government to decide to build a second refinery in the North. As expected, SACOR claimed its natural right to run the project, but CUF was also interested in entering a new profitable sector. The other contestants were SONAP and two distribution

multinationals, Mobil and Shell. Once again, the State put in practise its mediating capacity: SACOR and SONAP crossed shares and obtained the licence to build the new refinery.⁶⁷ Additionally, a commitment was made to include CUF in future projects, namely the construction of a third refinery (PETROSUL) in the 1970s.⁶⁸

Before describing how the steel industry developed, it is useful to make a reference to the ongoing process of concentration in the cement sector around this period. As stated earlier, two groups dominated the sector: SECIL, mostly owned by Danish capital, and *Empresa Cimentos de Leiria*, belonging to António Champalimaud. Actually, *Empresa de Cimentos de Leiria* was a powerful group, comprising several companies.⁶⁹ After expanding into the colonies, Champalimaud's strategy consisted in coordinating the control of the entire sector with SECIL, expanding its own factories in six-year cycles. Financing would rely mostly on his own funds, while colonial markets were targeted for investment outlets (Ribeiro et al., 1987).

In 1964, the Champalimaud Group decided to diversify its activities, entering two new sectors. Firstly, it bought *Cometna - Companhia Metalurgia*, to support the development of the steel industry — *Siderurgia Nacional* — and the cement activity, thus getting into the metalworking industry. Secondly, it started producing cellulose and paper, acquiring the control of two of the most important companies in the country — *Prado and Abelheira* — to supply *Kraft* paper bags for the cement industry.

The State decided for the construction of a first steel plant in 1954. *Siderurgia Nacional* included public as well as private capital. Champalimaud subscribed 50% of the social capital, leaving the rest to public and other private entities. The initial financing of PTE1 billion was granted by public entities, including *Fundo de Fomento Nacional*. *Siderurgia Nacional* also obtained a loan of PTE800 million, with public guarantee, in the form of deferment of payment for equipment (Ribeiro et al., 1987).

The State granted the new company exclusive production for ten years. In order to invest in the production of new steel products, namely railway tracks to sell the public railway company, it negotiated with the government a new protection regime: additional 15 years

⁶⁷ Both companies were already participated by *Compagnie Française des Pétroles*.

⁶⁸ The late 1960s and early 1970s also witnessed attempts of Portuguese fuel companies to control refineries and oil prospect projects in Angola.

⁶⁹ *Empresa de Cimentos de Leiria*, *Companhia de Cimentos do Tejo*, *Companhia de Carvões e Cimentos do Cabo Mondego*, *Companhia de Cimentos de Angola* (Zaire), *Companhia de Cimentos de Moçambique* (Beira), *Companhia de Cimentos de Moçambique* (Matola), *Companhia de Cimentos de Moçambique* (Nacala).

of exclusive producing and commercialisation in national territory (except colonies), tax benefits and new customs tariffs negotiated in the framework of EFTA⁷⁰. The project was financed with a foreign loan.

Finally, SACOR, CUF and Champalimaud also invested in the international expansion of its activities, not only to African colonies, but also to Brasil (Ribeiro et. al., 1987). This geographical diversification would prove pivotal for their reconstruction after the Revolution.

In sum, by the end of the 1960s, there were three main economic/industrial groups in the country: CUF, Champalimaud and SACOR. CUF was entirely controlled by the Mello family, as the Champalimaud family controlled the group centred around *Empresa de Cimentos de Leiria*. SACOR, on the other hand, was controlled by dispersed interests. Its main shareholders were *Grupo Espírito Santo* and *Grupo Português do Atlântico*, both financial conglomerates. It was also linked to *Grupo Borges e Irmão* in Angola, to CUF in Soponata and *Sociedade Portuguesa de Petroquímica*, and to Champalimaud in CIDLA. It did not therefore represent an autonomous centre of economic power.

Together, these conglomerates controlled almost every sector of the industrial landscape, besides having important stakes in services and agricultural activities and, as will be discussed next, in the financial sector. As the financial and political power of these oligopolistic groups grew, their specific interests interacted with and often determined the political orientations of the authoritarian regime. By the end of the 1960s, the national corporate structure was stabilised.

As the power of these groups consolidated, the State also created opportunities for smaller (but still powerful) companies in other areas. Queiroz Pereira obtained a licence to install and produce cement; new beer companies could join *Sociedade Central de Cervejas* and *Companhia União Fabril Portuense*, and the paper sector took in more participants.

In the late 1950s, difficulties in financing expansion projects, as well as the desire to achieve some level of independence vis-à-vis the State, led the industrial groups to move into the banking sector. In 1960, the Champalimaud Group acquired a position in *Banco Pinto e Sotto Mayor*. In 1961, CUF merged the newly bought *Banco Aliança* with *Banco Totta*, forming *Banco Totta Aliança*. This strategy had mutual advantages. The industrial conglomerates could easily use and transfer cash flows between units, had privileged

⁷⁰ Law 47 521, 3rd February 1967.

access to bank financing and other financial operations, and could use the banks' resources to control new activities. Banks, on the other hand, gained a secure client base in a relatively competitive environment.

Both the Champalimaud and CUF groups actively used *Banco Pinto e Sotto Mayor* and *Banco Totta* to finance their activities. In fact, it is difficult to consider the existence of these immense conglomerates without the support of a strong financial arm.

Figures 13 and 14 show CUF and Champalimaud's corporate structure based on the information in Martins (1973) and the available Annual Reports. This is, to my knowledge, the only attempt of a graphic accurate reconstitution of these groups' structures.

The CUF group – shown in Figure 13 – aggregated 187 companies and owned important stakes in other 254 firms (Amaral, 2015, p.40). Martins (1973) points to a different number: 100 companies were directly owned by CUF, representing more than 1/10 of the total corporate equity in Portugal. CUF itself represented 4,4% of the capital of all societies in the country (p.18).⁷¹ Its main sectors of activity were: chemical industry (1/3 of total sales in the sector), soaps, food oils (and other foodstuff), animal feeds, metalworking, textiles, fuel and naval construction. It also owned *Tabaqueira* (2/3 of total sales in the tobacco industry), and interests in paper and copper. Most of the companies in these sectors were created according to a logic of vertical control of the productive cycle (for example, the production of textile bags for selling fertilisers) or horizontal control, buying its competitors. It was a truly monopolist conglomerate.

CUF's productive centre were its chemical activities. Its diversification strategy was to buy, merge or create new companies operating in areas related to its core activities or in gaps across the production chain (transportation or plantation of raw materials). Most of the Group's companies were formed after the 1960s. Besides primary and secondary sectors, during this period CUF expanded into the tertiary sector: retail distribution, tourism, logistics, real estate, consultancy, casinos, etc.

By 1973, manufacturing activities represented 50% of the group's turnover, followed by financial services, with 19%, transportation and storage, with 15%, and wholesale and retail trade, with 10% (Silva, Amaral & Neves, 2016).

⁷¹ It is important to note that Martins' (1973) calculations might be overestimated. In her work, Martins considers that all the Group's stakes in different companies represent controlling positions. In reality, some of these participations represent less than 50% of the equity of the participated company.

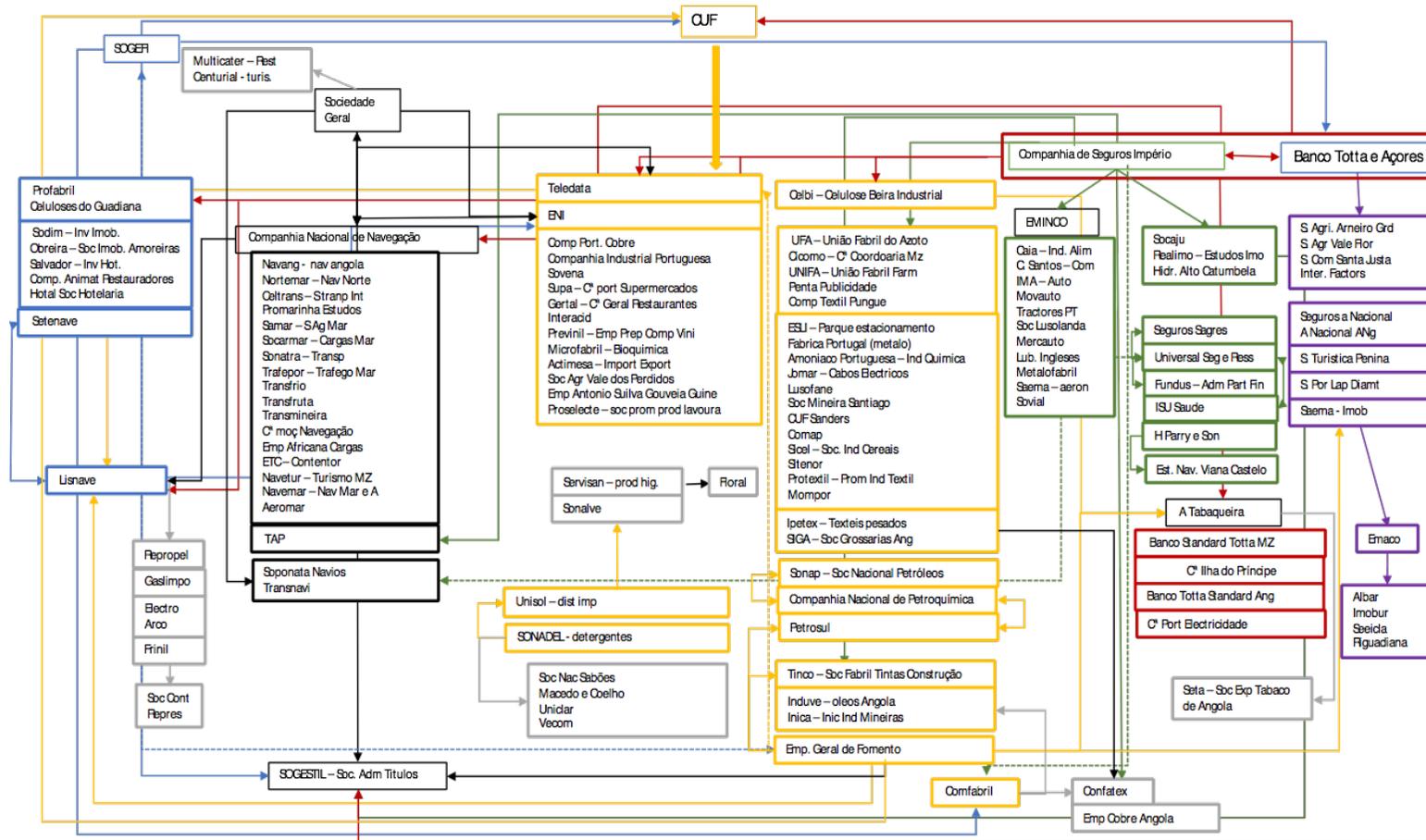
Overall, CUF had a highly complex corporate organisation, with several elements of opacity. Despite the importance of SOGEFI, the group was not structured in a pyramidal fashion, and there were multiple cross-shares between companies. Its structure adapted to the group's growth necessities, with multiple centres of control.

The Champalimaud Group was much less diversified than CUF.⁷² For twenty years, Champalimaud consolidated his position in cement production, buying the existing companies, until it controlled $\frac{3}{4}$ of total sales in the sector. The steel industry came afterwards, highly protected by the state. The group controlled $\frac{2}{3}$ of total steel and iron sales (Martins 1973, p. 36). In the 1960s, Champalimaud entered the banking and insurance sectors. Together, these activities represented 90% of the group's turnover (60% from steel and cements and 30% from finance) (Silva et al., 2015). Mostly after the 1960s, it also invested in the paper sector, from the production of wood to paper articles, and in tertiary activities (tourism, communication, information).

Compared to CUF, the structure of the Champalimaud Group was rather simple. The Group did not have a formal holding. However, António Champalimaud controlled *Companhia de Cimentos de Leiria* through Sommer and Cia. Insurance companies and *Banco Pinto e Sotto Mayor* served as sub-holdings.

⁷² In the 1960s CUF was already in its third generation of family management, while Champalimaud's was still the first.

Figure 13 – CUF Group: corporate structure



Source: Own elaboration based on Martins (1973).

Apart from banks, insurance companies were crucial to finance non-financial companies, inserted in these groups through a complex system of holdings. These holdings were very seldom used for pure organisational purposes. The objective was, as far as it is possible to understand, to hide the real shareholder structure of the group, to maximise control minimising the financial capital committed to equity, or to facilitate the circulation of financial flows, sometimes through illegal schemes. Shadow companies whose only purpose was to serve as financial intermediators or concentrate financial risk away from main companies were rather common. These units required little equity but were largely indebted. Its assets were mostly titles – stocks or bonds – issued by related companies.

In the case of Champalimaud's Group, there were holding companies whose balance sheet was basically composed of inflated financial participations funded by short-term debt. As an example, SOMMER & Cia had an equity worth PTE 3 million, plus PTE 9,6 million in reserves and its assets were basically stocks, quotas issued by *Empresa de Cimentos de Leiria*, *Banco Nacional Ultramarino*, *Companhia de Cimentos do Tejo* and *Transformal*.⁷³ It had also bonds and other loans, probably issued or granted to related companies. Out of PTE 7.346.881,9 registered as debts, PTE 5.948.440,7 were considered non-performing debts. Its debts amounted to PTE 45.931.755, accruing interests of PTE 2.764.414, which compare with a financial income of PTE 9.435. In that year, the net loss was PTE 4.319.567.

In 1960, Champalimaud decided to buy the insurance company *Confiança* and *Banco Pinto e Sotto Mayor* (BPSM) from Manuel Henriques Júnior. To close the operation, Champalimaud transferred a deposit to *Banco Pinto & Sotto Mayor* and wrote a (partially) bounced check on his own account. Part of the amount never even existed, but by the maturity date of the check, the bank was already property of the Champalimaud Group (Costa et al., 2010). The bank was bought with its own money.

Both BPSM and *Confiança* were crucial to finance the group. In the case of later, 80% of its investment portfolio was applied in securities issued within the group of António Champalimaud (dos Santos, 1977).

Unlike the Champalimaud Group, who acquired BPSM in the early 1960s, the banking house José Henriques Totta had been part of the CUF group since 1921. In 1961, *Banco José Henriques Totta* merged with *Banco Aliança*. Out of the deal emerges *Banco Totta*

⁷³ Arquivo Contemporâneo do Ministério das Finanças, Informação da Inspeção Geral de Finanças ao Ministério 30/06/1975. There is also a reference to another company whose name was not visible in the original document.

Aliança. In 1966, CUF founded two new banks, one in Mozambique (Standard-Totta) and another in Angola (Totta-Standard). In 1969, after a failed attempt to control *Banco Fonecas & Burnay*, *Banco Totta Aliança* engages in a new merging operation, this time with *Banco Lisboa & Açores*. The latter had been the most important bank in the system during the first decades of the Twentieth Century and merged, in turn, with *Banco da Madeira*, an important regional bank, in 1965.

Banco Totta & Açores was the fourth largest in the country, with a market share of about 11%. It was participated (in its majority) by the CUF group, through *Sociedade Geral de Comércio*, but the bank also owned important participations in companies belonging to the group.

In 1974, a report, elaborated by António Roque Antunes, delegate of the *Banco de Portugal*, provides some additional information on the activity of *Banco Totta & Açores*.⁷⁴ By 1973, the entire loan portfolio was worth PTE 19.090.679.000, and 96% of this value was committed to short-term loans (less than one year). Companies within the CUF group absorbed 15,6% (PTE 3.710.000.000) of the total loans.

Compared to other banks, this exposure seems relatively small. There were, however, other indirect forms to finance the group.

Due to the nature of its activity, insurance companies had large pools of liquidity to distribute. According to dos Santos (1977), in 1973, *Império*, *Sagres* and *Universal* had PTE 1,5 billion invested in companies from the CUF Group. In relative terms, these investments corresponded to 80% of *Império* and more than 90% of *Sagres* and *Universal* portfolios.

In 1965, CUF created one of the first investment funds in the country: *Fundo para o Desenvolvimento Económico e Social* (FIDES)⁷⁵. Its main shareholder was SOGESTIL, also constituted around 1964 and owned in 96% by CUF companies. *Banco Totta* and CUF's insurance companies had a crucial role in financing and sustaining the value of the fund in the case of early redemption requests. Even though it was against the law, SOGESTIL, managers and members of the Mello family kept credit lines within *Banco Totta* to finance FIDES operations. These operations were often backed by titles issued

⁷⁴ Antunes, António Roque, Delegado no Banco Totta & Açores – *Relatório de Dezembro de 1974, Arquivo Histórico do Banco de Portugal*.

⁷⁵ Fund for social and economic development.

by FIDES or SOGESTIL. According to the investigation report, FIDES would buy its titles directly or using individual investors as frontmen. Either way, the volume of purchases contributed to the scarcity of securities in the markets, raising its prices.⁷⁶ The fund's value was also inflated with profits resulting from fake sells of securities, followed by repurchase operations at the same value, or by pricing non-listed titles above its real value. Overall, the speculation process resulted in a valorisation of more than 100% in the price of participation units (from PTE 150,40 in October 1972 to PTE 313,30 in February 1974).

FIDES portfolio was distributed between banking institutions (30,5%), insurance companies (14,8%) and chemical and fuel companies (11,7%). More than 47% of the fund's investments was applied in CUF's companies: 4% in *Banco Totta*, 4% in the insurance company *Império*, 9% in CUF, 4% in *Tabaqueira*, and 6,5% in CELBI. Some of these securities were bought below its market price, often over-the-counter, and sometimes receiving FIDES participation units as payment.

Both reports express the same conclusion: the true purpose of FIDES was not to invest in the economy, but to help the CUF Group financing its non-performing companies, as well as consolidating its own economic position.

5.4.4. Groups with financial origins

Whilst industrial groups started acquiring important positions in the financial sector, the reverse process also took place. In late 1960s, after a process of concentration in the banking sector, private banks that were not controlled by CUF or Champalimaud evolved into large mixed conglomerates.

The Espírito Santo Group

Banco Espírito Santo was the bank of all regimes and emerged in the aftermath of the Second World War as the largest (private) commercial bank in the country.⁷⁷ In the meantime, it was transformed in *Banco Espírito Santo e Comercial de Lisboa* (BESCL), by the absorption of *Banco Comercial de Lisboa* in 1937.

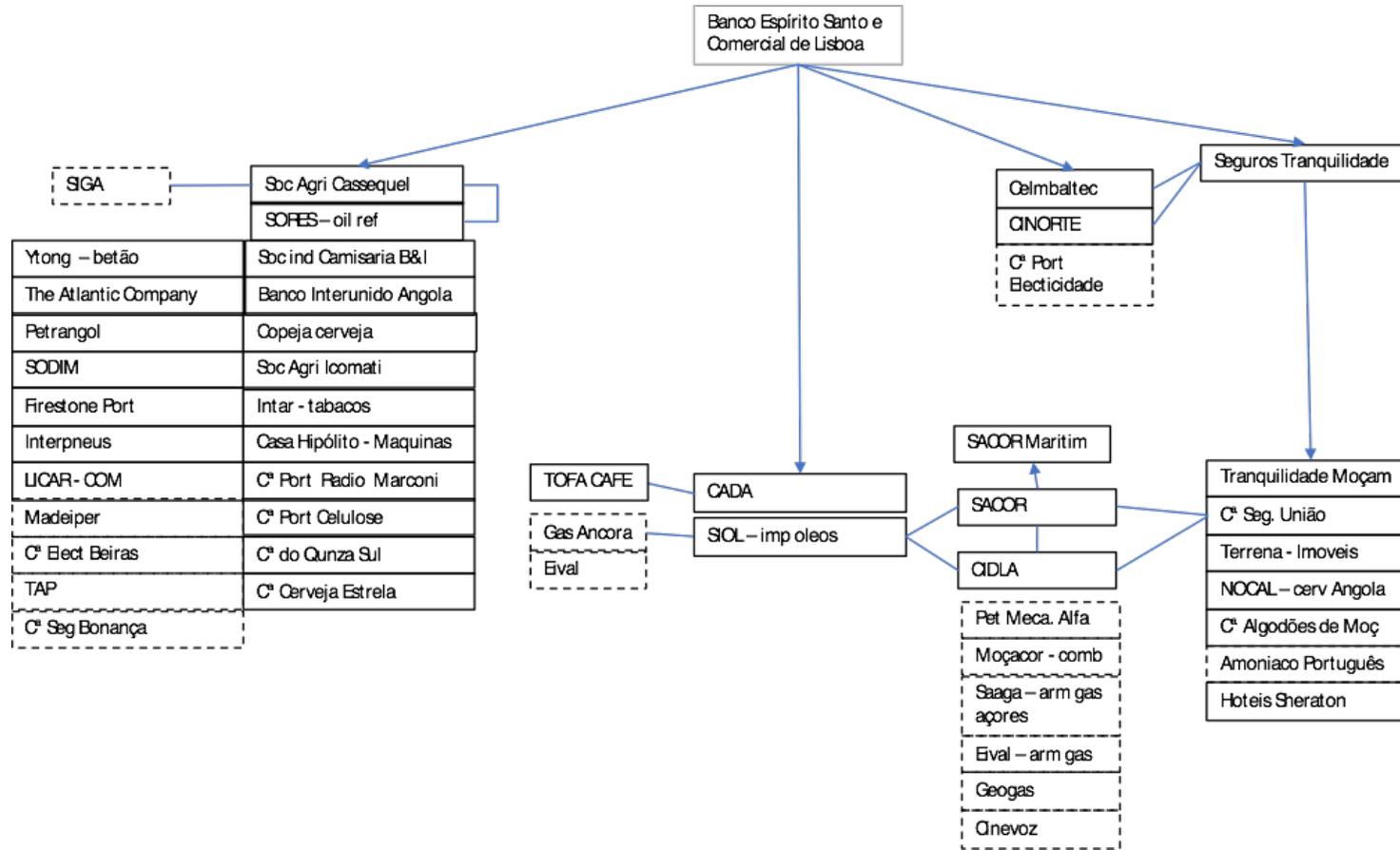
⁷⁶ Arquivo Contemporâneo do Ministério das Finanças, *Inspecção Geral de Crédito e Seguros*.

⁷⁷ 'Discurso Directo com Ricardo Salgado', DN videos, 11th April 2010

In 1955, the Espírito Santo Group was already in its second generation of bankers. Manuel Espírito Santo, the founder's youngest son, assumed the presidency, while several family branches occupied leading positions in different companies. The Espírito Santo family was large, with numerous marriage connections, namely to the Mello family (CUF) and to families from the old nobility. The unity of the group depended on difficult internal balances within the family and its branches, or *clans*.

These groups never had a formal family holding company. The Espírito Santo family met informally to take the most important management decisions and the group was controlled through *Banco Espírito Santo e Comercial de Lisboa*, whose structure is presented in Figure 15.

Figure 15 – *Espírito Santo* Group: corporate structure



Source: Own elaboration based on Martins (1973).

The group's main activities were always centred around the financial sector. Financial services represented 69% of the group's turnover in 1973, while agriculture was at 14%, information 8%, and manufacturing 5% (Silva et al, 2015). Outside its core activity, the Espírito Santo Group started expanding its business, but mostly based on minority stakes. One of the justifications for it was the law determining that banks's stocks in non-financing companies could not exceed 20% of the bank's capital.⁷⁸ It is important to say, however, that this rule was often bypassed through complex schemes of cross shareholdings or fake holding companies. The general lack of detailed information determined that not all of these companies could be captured in the reconstituted structure presented in Figure 15.

Another characteristic of the Espírito Santo Group was their proximity to the fascist regime. In some cases, like SACOR (oil refining) or *Companhia Portuguesa de Celulose* (paper), the State was also a shareholder. In other cases, the government would request the presence of Espírito Santo to meet the rule of 51% of Portuguese capital in major economic projects.

In the turn of the Twentieth Century, the group moved to other areas outside banking: insurance (*Tranquilidade*), real estate, colonial agriculture (*Companhia Açucareira do Buzi* and *Sociedade Agricola do Cassequel*, *Companhia de Moçambique*, *Sociedade Agricola do Incomati* and CADA)⁷⁹, and, later, oil refining (SACOR). The Espírito Santo family was also in the car import business since the 1940s, first with MOCAR and, from 1967 onwards, with SANTOMAR.

In the 1950s it formed, together with several other capitalists (Queiroz Pereira, Manuel Boullosa, Manuel de Mello, among others) the real estate society Sodim. Also in that decade, the family got into the tyre industry. In 1955 BESCL bought 80% of *Herdade da Comporta*, a property with 15.000 hectares of land, from the English Atlantic Company.

In the telecommunication sector, the Group took the opportunity created by the government decision, in 1966, to impose a change in the capital structure of *Companhia Portuguesa Rádio Marconi* (CPRM). The new concession required the nationalisation of part of the capital and the selling of an additional share to a Portuguese private group. Together, both should own 51% of the capital. BESCL acquired 15% of CPRM.

⁷⁸ Decree Law 42641, 12th November 1959, art. 67°.

⁷⁹ CADA was the largest coffee company in the whole metropolitan and colonial territory.

In 1971, *Banco Inter-Unido* was created in Angola, in a joint venture with the First National City Bank of New York. In the same year, BESCL was invited to join the Chase Manhattan Bank, Credito Italiano, Mitsubishi, Ltd, National Westminster Ltd, the Royal Bank of Canada, the Swiss Bank Corporation, and the Westdeutsche Landesbank Girozentrale, and to found the Libra Bank, in London. The main purpose of the new bank was to focus on Latin American markets.

In 1973, the Group bought the majority of the capital of the largest sugar producing company in Angola (*Companhia do Açúcar de Angola*) and of an oil refining company, *Refinaria Angola*. It also had a share in ANGOL, a joint venture between SACOR and PETROFINA.

Other interests included *Companhia de Cervejas Estrela* and *Sociedade Central de Cervejas*, in the beer sector, and CINORTE, in the cement one. Both investments resulted from the political decision, taken in the late 1960s and early 1970s, to open up some of the protected areas and allow new projects, granted to new groups.

Espírito Santo's insurance company – Tranquilidade – played an important role, both as holding company, but also a source of financing. According to Dos Santos (1977), in 1973, 54% of the company's securities portfolio was invested in the group.

Banco Borges & Irmão

The Borges Group was the most diversified and the largest (considering the number of companies it included) of the bank-based groups. In 1973, it comprised 87 companies in 19 different sectors. The largest share of the group's turnover — 41% — came from financial activities. Manufacturing represented 30% and construction 12% (Silva et al. 2015).

It started as a banking and trading house, linked to wine producing interests in the North. During the 1940s, it got into textile and tyre production (MABOR), and insurance and hotel related activities afterwards. *Banco Borges e Irmão* was an important creditor in textile sector and, after the crisis of 1966-1967, when a large number of companies went bankrupted, the bank became a shareholder in some of these firms (Menko-Raione) (Martins, 1973).

In the late 1960s, the group expanded into a myriad of manufacturing and tertiary activities: beverages (SOGERE), synthetic fibres (EUROFIL), petroleum products (ANGOL), ceramics, metal products (SOCITREL), construction (ICESA), fishing (*Companhia Portuguesa de Pesca*), real estate, travel services, etc (Silva et al., 2015 and Martins, 1973). After having consolidated some of these activities in Portugal, the group moved into the colonies. *Banco de Crédito Comercial e Industrial* was created in 1965, with branches in Angola and Mozambique.

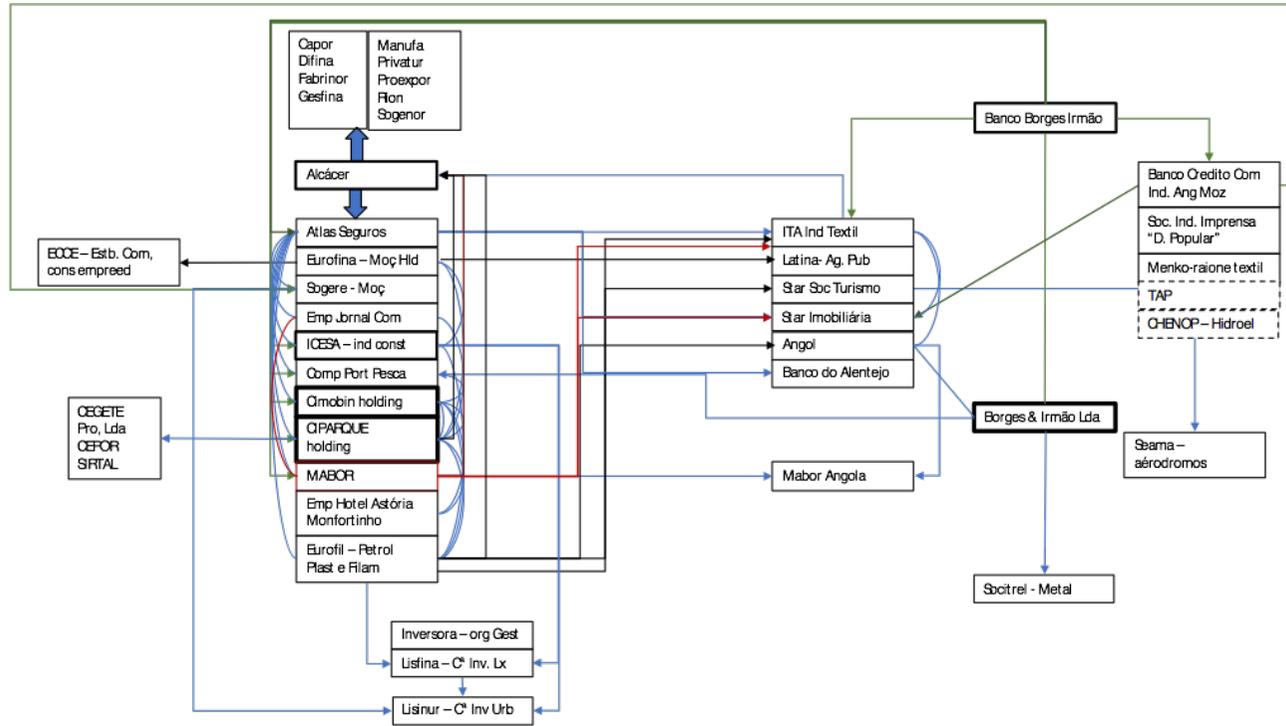
Finally, the Borges group owned three important newspapers: *O Primeiro de Janeiro*, *Diário Popular* and *Jornal de Comércio*.

According to Silva et al. (2015), to control such a vast group of companies in different areas, the Borges Group created 32 small financial holdings, with cross shareholdings between them. The main goal was to avoid legal restrictions, and to maintain the level of participation, by having the bank financing the several holding companies.

The reconstruction of *Grupo Borges & Irmão* in Figure 16 clearly depicts its type of structure. There are some inconsistencies between the companies identified in Silva et al (2015), Martins (1973) and the official reports, probably because different methodologies were used and the studies focused on different aspects of the group. A document elaborated after 1974 by the ministry of finance⁸⁰ reports the existence of five main subgroups within Borges & Irmão: Alcácer (Capor, Difina, Fabrinor, Gesfina, Inversora, Lisfina, Manufa, Privatur, Proexpor, Rion and Sogenor), *Borges & Irmão Comercial*, Promotora (Promotora, Surto, Cisa, Defionio, Primal), ICESA (Contrial, INCA) and CIPARQUE. Out of these companies, eight had negative results in December of 1974.

⁸⁰ *Arquivo Contemporâneo do Ministério das Finanças. PT/ACMF/SETF/GSET/ICR/001/004/009 COD062644*

Figure 16 – *Borges & Irmão* Group: corporate structure



Source: Own elaboration based on Martins (1973).

Regardless of the exact methodology, it is visible how the Bank controlled the conglomerate through a limited number of (minority) participations, using circular participation schemes between the different holding companies.

This conclusion is validated by several reports published in 1975 with the main goal of evaluating the banks' credit operations.⁸¹ According to those reports, the complex structure of *Grupo Borges & Irmão* allowed its CEO, Miguel Quina, and his family, the main shareholders of the bank, to control a vast conglomerate of financial and non-financial companies. This structure was mainly dependent on financing provided by the bank.

In fact, 35% of *Banco Borges & Irmão*'s total credit was concentrated in 73 companies linked to its own group. Almost half of this proportion (44%) went to 26 real estate and investment companies; 5% to one construction company; 5% to three commerce companies; 8% to eight companies providing services; 8% to two companies operating in the plastics sector; 10% to eight textile companies and 20% to other 26 companies in different activities. 51% of the commercial loan's portfolio was concentrated in 183 companies; out of these, 48 companies connected to the group benefited from 67% of the total amount of guarantees granted by the bank; and 88% of the overdraft credit was conceded to 20 companies, again all of them linked to the group. Furthermore, the constant rollover of these overdraft operations indicated that these were, in fact, medium-term loans. The report also indicates that these intra-group credit operations did not follow the normal credit approval circuit and were directly decided by the CEO.

There is also information considering seven specific companies, which were part of the Borges group: *Fábrica de Lanifícios do Lordelo*, FABRINOR – *Soc. Estudos e Projectos Fabris*, CIPARQUE – *Companhia Imobiliária do Parte*, INCA, SURTO, CEGESTE – *Centro de Estudos e Gestão Económica*, and ALCÁCER – *Companhia de Investimentos Financeiros, Industriais e Agrícolas*. The bank's exposure to these companies accounted for more than 10% of its own funds.

Apart from *Fábrica de Lanifícios do Lordelo*, none of these companies had a productive activity. These were mainly holding companies. In fact, 44% of the group's companies

⁸¹ Teixeira, Octávio Augusto, Relatório Banco Borges e Irmão (n.º 1,2), 09/01/1975, 12/02/1975 *Arquivo Histórico do Banco de Portugal*; Teixeira, Octávio Augusto, *Empresas associadas do Banco Borges*, 06/03/1975, *Arquivo Histórico do Banco de Portugal*.

were financial holdings and absorbed 53% of the total credit granted to the Group (16% of the bank's total credit portfolio).

As an example, ALCÁCER, the group's main holding company, had a social capital of PTE 1 million but financial participations of PTE 65 million and ongoing fixed investments of 170.645.000 PTE. These investments were almost entirely financed by *Banco Borges e Irmão* since its exposure to ALCÁCER was PTE 170 million in loans and guarantees.

Overall, as referred by Noronha (2011), there is a pattern in these companies: little capital, large medium and long-term investments (real estate and financial participations), most of them rather illiquid, financed by short-term debt granted by the bank. In general, these short-term liabilities (vis-à-vis the bank) were greater than the assets.

Another report by Octávio Teixeira describes several shadow accounts opened in *Banco Borges e Irmão* under fake names.⁸² All these accounts served to obtain short-term loans from the bank. This debt was used to finance the group's holding companies, constituted with the minimum legal equity (PTE 50.000), and whose assets were exclusively stocks from other companies within the group. By financing these companies through shadow accounts, the bank could register these accumulated flows as an asset (loan) and not as a financial cost.

Banco Português do Atlântico

Banco Português do Atlântico (BPA) was founded in 1942. Its origins are in the banking house Cupertino de Miranda & C.^a. For decades, the bank was kept under the control of Arthur Cupertino de Miranda (1892-1988), owner and CEO of the bank. From the beginning, BPA was directed to support business activities in the north, as well as major public investments such as the national electrification project.

In 1956, it received authorisation to establish *Banco Comercial de Angola*, controlling 50% of its capital. In 1964, it absorbed *Banco Raposo de Magalhães*. It was the first bank to issue and distribute stocks to its own clients (17500 in total, corresponding to a capital increase from PTE 250 million to PTE 400 million), in 1966.

⁸² *Arquivo Contemporâneo do Ministério das Finanças, Fundo do Gabinete do Ministro das Finanças, 14-Inspeção-Geral de Crédito e Seguros, ref 0007 0178 1801.*

In 1970, after a long-lasting conflict, Arthur Cupertino de Miranda requested the approval of the general assembly to sell its share in BPA to Champalimaud. The deal, which would imply the merger of BPA with BPSM, was directly stopped by the government and required specific legislation.

The independent character of BPA might have prevented its explicit utilisation as a source of direct financing by a specific conglomerate. BPA had a simple corporate structure and it could not be considered a mixed conglomerate. However, in 1974, 64% of its credits were concentrated in 2% of the customers, and 52% of the credits in just 1% (205).⁸³ Among its largest debtors was the CUF Group, SACOR, other major companies in the country, and its own CEO, Cupertino de Miranda.

Banco FONSECAS & Burnay

The heart of *Grupo FONSECAS e Burnay* was *Banco FONSECAS e Burnay* (BFB), created in 1967 from a merger operation between Banco FONSECAS Santos⁸⁴ & Viana and Banco Burnay.⁸⁵

Because of that merger, in 1973, *Banco FONSECAS & Burnay* had the fourth largest portfolio of participations in other companies.⁸⁶ However, in that year the bank was still dealing with the consequences of a conflict between the Figueiredo family and the CUF Group over the control of the bank. The war started in 1969 when, faced with a change in the leadership of BFB, the CUF group decided to proceed with its intention to merge this bank with *Banco Totta*, secretly acquiring the position from other shareholders.⁸⁷ To avoid any dilution that would endanger the delicate equilibrium, BFB did not raise its capital, which was, in 1973, the 13th in all of the banking system.

As shown in Figure 17, *Banco FONSECAS & Burnay*'s structure was relatively simple.

⁸³ Report by António Vasco Consigieri Pedroso, 13-01-1975. Reports by the bank delegates. *Arquivo do Banco de Portugal*.

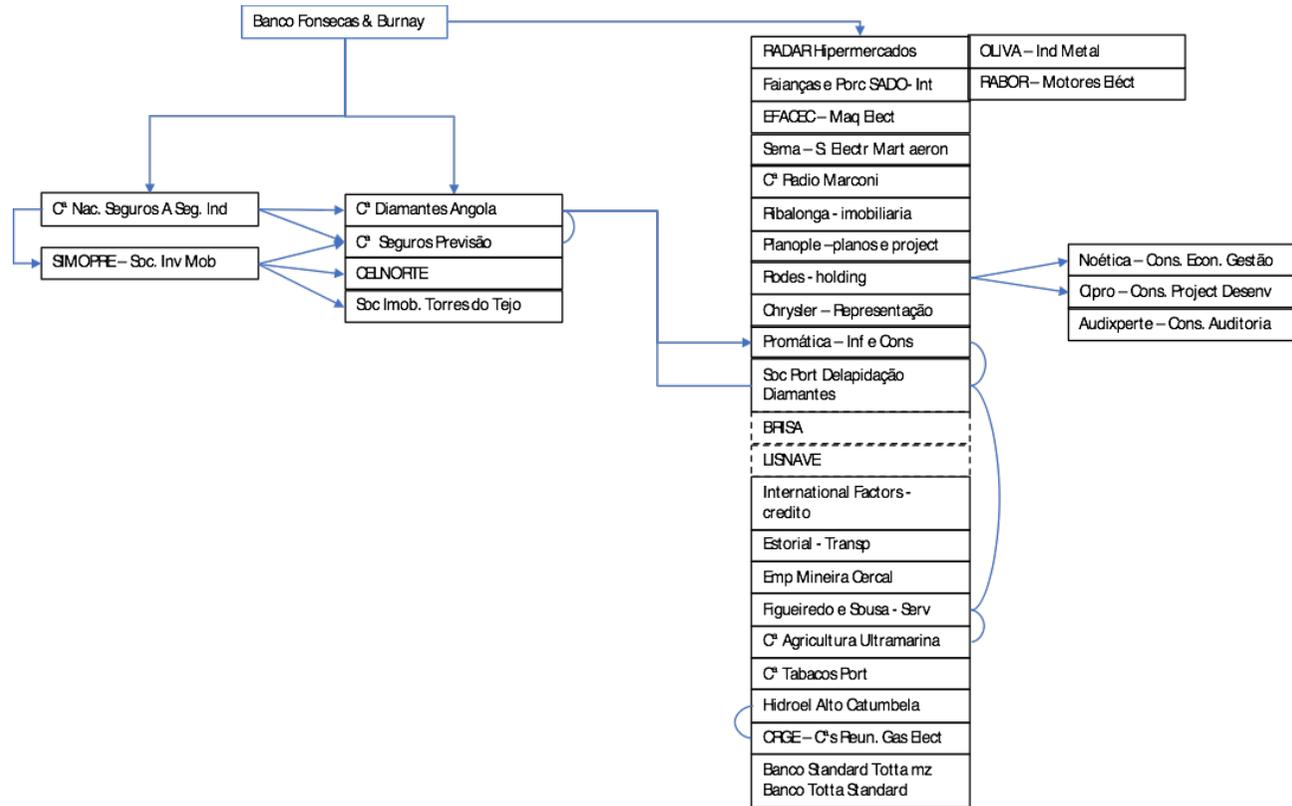
⁸⁴ Which belonged to the Figueiredo Family, heirs of the slave traffickers Sousa brothers.

⁸⁵ Around 1920, due to succession problems, the Group Burnay ended up being controlled by Société Générale de la Belgique and was sold in the 1960s to a group of Portuguese entrepreneurs (Silva et al. 2015).

⁸⁶ Part of these companies – Figueiredo & Sousa, Companhia Agricola Ultramarina, Sociedade Estoril — came from the Figueiredo family, while others – CRGE, DIAMANG – were represented by the Burnay family

⁸⁷ *Arquivo Contemporâneo do Ministério das Finanças*. PT-ACMF-SETF-GSEF-036-002-0010.

Figure 17 – Banco Fonseca & Burnay Group: corporate structure



Source: Own elaboration based on Martins (1973).

The bank had a direct participation in several financial and non-financial important companies. It owned 51% of Portuguese Chrysler, 10% of Brisa (the motorway concession holder), 5% of CRGE (electricity and gas), 5% of *Companhia de Diamantes de Angola*, 10% of CELNORTE (paper pulp) with *Grupo Português do Atlântico*, 7% of Marconi (telecommunications) with the Espírito Santo family. It was also connected to the CUF Group through LISNAVE, *International Factors* and its banks in Africa, Santandard-Totta and Totta Sandard (Martins, 1973). Apart from the two insurance companies, *Seguradora Industrial and Previsão*, SIMOPRE and RODES worked as the group's main holding companies.

Despite the diversification of its investments, in 1973, 73% of the group's turnover came from financial activities, and only 13% from mining, followed by 9% from manufacturing (Silva et al. 2015).

According to a report prepared by the Credit Inspection in 1975, the bank was granting several loans to its managers and directors, so these could, in turn, acquire lots of stocks of SIMOPRE and Chrysler.⁸⁸

According to the report, the bank's participation in SIMOPRE (100%), RADAR – *Hipermercados* (94,72% Wholesale), and Chrysler (51%), which was above the legal 20% law, 'was secured through "charitable" shareholders and individuals, usually directors of BFB'. Furthermore, the bank was being charged for having granted large loans to SIMOPRE, well above the limit of 10% of its own capital, and for having registered the operations as real estate secured loans.

Another report, prepared by Silveira Godinho in 1975, states that a large proportion of Banco Fonsecas e Burnay credit was being directed to a small number of large companies: Celnorte, CP, *Metalúrgica Duarte Ferreira*, Efacec, C.R.G.E., Simopre, Sorefame, Saponata, TAP, SAPEC, CEL- CAT, Econave, Setenav, Delur, Lisnave, CUF, INEL, Ford Lusitana, and SACOR.⁸⁹ In 1974, 54% of total overdraft lines of credit belonged to ten companies, while 60,8% of loans requested by SMEs were rejected.

⁸⁸ *Arquivo Contemporâneo do Ministério das Finanças*. PT-ACMF-SETF-GSEF-036-002-0010, Code: 033471.

⁸⁹ Godinho, J.A. Silveira, Report from the representative of *Banco de Portugal* in *Banco Fonsecas & Burnay* (from 16th to 31st December 1974), *Arquivo do Banco de Portugal*.

Grupo Banco Nacional Ultramarino (BNU)

BNU was established in 1864, with the purpose of investing in Portuguese colonies in Africa and Asia and facilitating the introduction of a unified currency in the Portuguese territory as a whole. It then became sole issuing bank in the colonies. At first, it was a private bank (created by a syndicate of businessmen), but with unique privileges: a subsidy of 30.000 Reis/year to keep its subsidiaries in Africa, and exemption from all taxes and pecuniary duties. In the beginning of the Twentieth Century, the bank expanded into Portuguese territories to assure money transfers between settlers in the colonies. BNU was also one of the main financial supporters of the State's military expenses to keep the territories overseas. In 1919, a new legal framework allowed the setting up of new banks in colonial territories, albeit consolidating the role of BNU as the issuing bank. In 1926, Banco de Angola was created as an issuing bank in that territory, but BNU kept its position in the remaining colonies. In 1929, a new contract reaffirmed BNU's role in the colonies: issuing bank for Cabo Verde, Guinea, S. Tomé e Príncipe, Mozambique, India, Macau e Timor; commercial bank; and participant in colonial development plans. The new contract also determined the government's participation in the bank's administration.

In 1930, coping with an economic crisis in the colonies, and considering its credits vis-à-vis BNU, the bank faced serious limitations to its activity. The government created *Banco de Fomento Colonial* to support economic and agricultural activities, at the expense of BNU's expansion in the area. Its administration resigned, and the State became BNU's main shareholder and supporter through *Caixa Geral de Depósitos*. After that episode, the bank would recover its crucial position in the economy of Portuguese colonies.

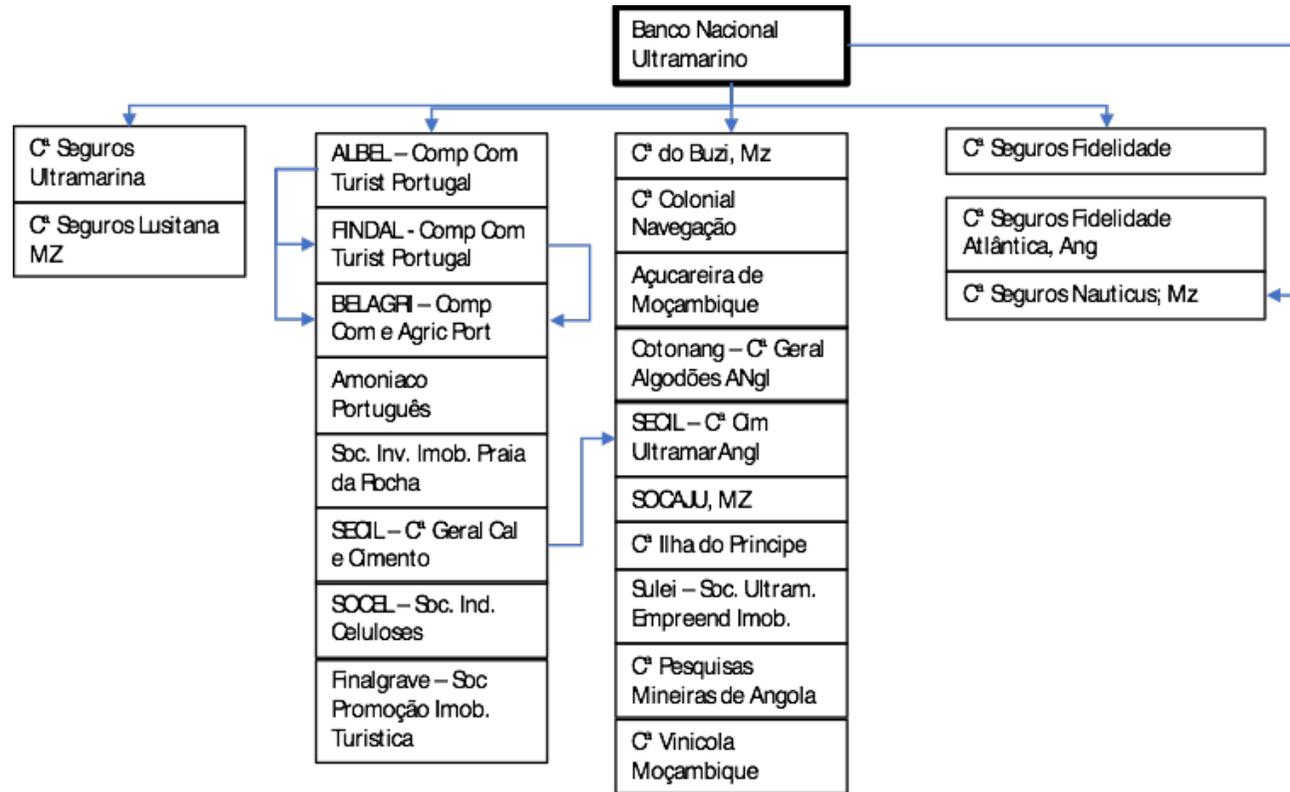
In 1953, a new contract established the terms of BNU's activities therein: issuing bank in all territories except Angola; bearer of the obligation to finance the government; treasurer for the local administration. The fifties were years of growth for BNU, leveraged on the financing of large public investments included in national development plans.

In 1961, already under the first effects of the Colonial War, BNU merged with *Banco Ferreira Alves & Pinto Leite*, from Oporto. BNU was, at the time, the most important bank in the country. In the second half of the decade, other banks started their activity in Africa, namely Mozambique (*Banco Pinto & Sotto Mayor*, *Banco de Crédito Comercial*

e Industrial). Nevertheless, BNU kept its activity as the state's main financier in Africa, often charging interest rates below the market benchmark.

The short summary of BNU's history shows how the bank was inexorably linked to the Portuguese State's intervention in its colonial territories. This specialisation reflected in the structure and composition of the group, presented in Figure 18.

Figure 18 – Banco Nacional Ultramarino Group: corporate structure



Source: Own elaboration based on Martins (1973).

In the insurance sector, BNU controlled *Fidelidade* (Portugal), *Fidelidade Atlântica* (Angola), *Companhia de Seguros Lusitana* (Mozambique), *Companhia de Seguros Náuticos*, and held a participation in *Companhia de Seguros Ultramarina* (Portugal).

BNU's relation with the colonies determined its presence in local agricultural and manufacturing sectors: *Companhia do Buzi*, *Cotonang-Companhia Geral dos Algodões de Angola*, *Companhia da Ilha do Principe* (with CUF), *Açucareira de Moçambique*, *Companhia de Celulose do Ultramar Português* (paper in Angola), SOCAJU (with CUF), *Companhia de Cimentos Secil do Ultramar* (cement).

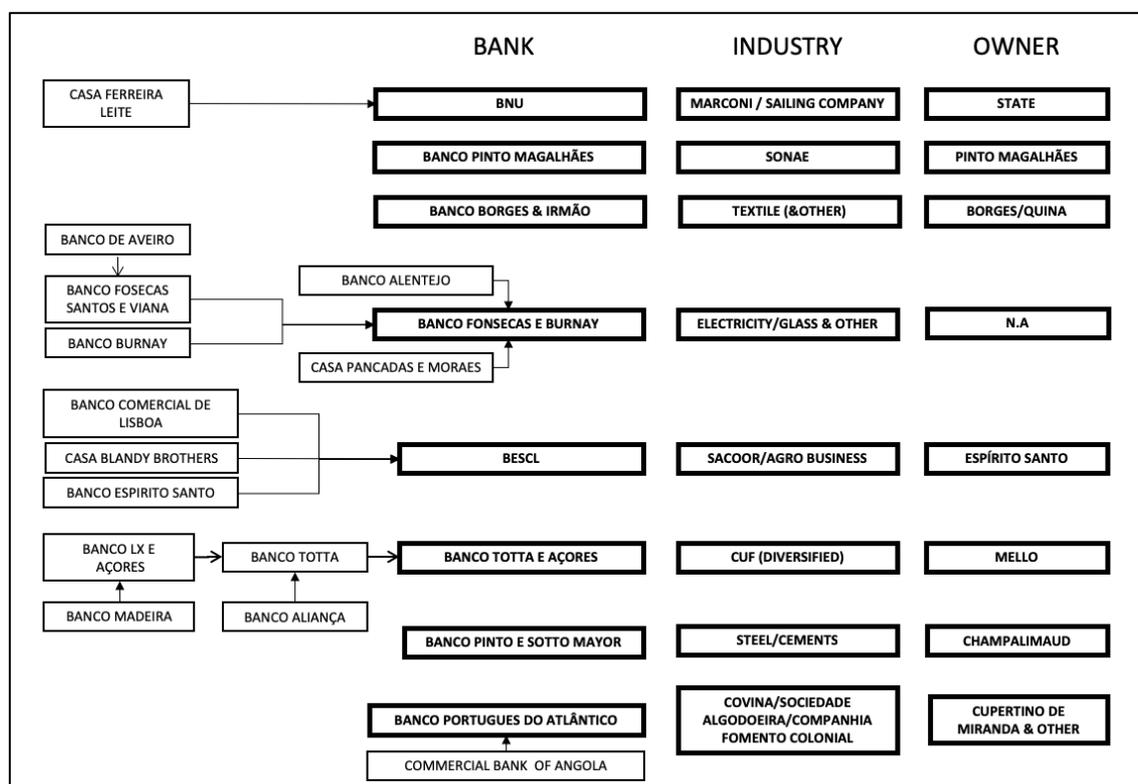
In Portugal, the bank had 20% of *Companhia Colonial de Navegação*, several participations in the tourism sector, and in Secil (cement), Socel (paper) and *Amoníaco Português* (chemicals).

5.4.5. Mixed Conglomerates

In 1974, the main groups analysed in the previous sections have evolved into mixed conglomerates that dominated that Portuguese, holding monopolistic and oligopolistic positions in several sectors.

These conglomerates were the result of concentration processes, partially promoted by the State, and shared common characteristics, as shown in Figure 19:

Figure 19 – Structure of mixed conglomerates



Source: Own elaboration based on Silva et al. (2016), Martins (1973) and Costa et al (2010).

Whether from industrial or financial origins, these large conglomerates were controlled by one specific family, and usually had two business arms: one industrial sub-group with vast interests in sectors protected by the State and deeply connected to colonial markets; and one financial sub-group, formed by banks and insurance companies, crucial to generate internal means of financing.

Such powerful groups were a key constitutive element of the authoritarian regime. They developed through the exploitation of rents and coexisted comfortably with the country's social and economic backwardness, with colonialism, with cheap and unskilled labour and a poor business landscape. They were not interested in developing the Portuguese economy, but on expanding the economic power brought about by the control of key sectors. This control was achieved and held by the mobilisation of their political and family networks, the ownership of the banking sector and by circumventing existing regulations, whether through financial fraud or by keeping a state of permanent excess capacity to prevent the arrival of new competitors in their areas of interest.

5.5. Final Remarks

The task assigned in the present chapter was not simple in any way. The purpose was to find the main elements that supported the concentration and accumulation of capital in Portugal for 150 years.

In the first place, it has been demonstrated that, historically, the formation of large capitalist fortunes is 'not the outcome of operations in the markets of goods and services' (Toporowski, 2016a, para.14). Moreover, it is also clear that a necessary correspondence between the accumulation of capital by large conglomerates and the country's productive development is an ideological construction. In reality, it is possible to have concentration and accumulation of capital without clear productive improvements.

Indeed, that was the case for the greatest part of the 150 years under analysis. Until the second half of the Twentieth Century, the success of the Portuguese bourgeoisie was disconnected from the country's industrial or productive performance. Far from it: they have chosen protection and privilege over modernisation. In rural areas, the interests of large landlords prevailed over a much-needed agrarian reform that could increase productivity and support industrial transformation. In urban centres, the capitalists' attentions were directed to gains from colonial trade and financial activities.

The 1881 Industrial Inquiry in Portugal mentions a 'mutilated history, to which the preface is missing — the industrial credit —, as well as the epilogue — ample markets open to consumption'.

The description offered by Fonseca & Reis (1987) corroborates this interpretation:

'in the absence of an authentic, capitalistic and entrepreneur bourgeoisie, that which was not mobilised in rents and loans to the State was wrecked in excessive and ostentatious consumptions, leaving a final balance for productive investment that was too small to take the country out of its ancestral poverty.' (p.867)

The State, whether as a monarchy or a fascist authoritarian regime, was no stranger to this process of unproductive accumulation. It was, in fact, its greatest promoter.

To begin with, the State offered the growing financial and speculative bourgeoisie what the rural nobility already had: social and political legitimacy. In second place, it granted access to the most profitable lines of business — the tobacco monopoly, colonial trade

lines, financing of public debt – and protected the few existing industries – textiles and footwear – without evident economic gains.

This state of affairs outlived the monarchy, the First Republic, and it was not substantially altered during the first half of the dictatorship. CUF and Champalimaud, the two industrial groups that emerged from this structurally underdeveloped economy, carried its marks: strong connections to colonial and protected markets, valuable political relations, important family vertical networks, strengthened by inter-family matrimonies and the control of the banking sector.

The same State that (until the mid 1900s) had nurtured a predominantly unproductive bourgeoisie was responsible for the creation of an industrial capitalist class after the Second World War. Protection and concentration were two key elements of the fascist industrial policy, that changed the existing structure of incentives – rents – away from mere extractive or speculative activities to heavy manufacturing sectors.

The choice towards steel, metalworking, oil refining, shipbuilding and industries alike did not happen naturally for Portuguese capitalists. To a large extent, the bulk of investment involved in developing the country's productive structure was promoted, financed, planned and protected directly or indirectly by the State: directly through the industrial conditioning policies and industrial development plans, designed to favour a small number of elected economic conglomerates; and indirectly through the maintenance and protection of colonial markets, price controls in agriculture, and a coercive system to repress workers' aspirations and demands.

Notwithstanding, the fascist government's control over the strategies of large conglomerates seems to have been mostly focused on industrial sectors. Although finance was responsible for large shares of these conglomerates' turnover and profits, the level of autonomy for such activities in the private sector was large.

The fact that mixed conglomerates emerged as the predominant form of organisation of economic conglomerates is self-explanatory regarding the strategic role of the financial sector in the capitalist accumulation process. One can argue that the ownership of banks and insurance companies in close connection to the industrial companies compensated for the structural lack of stable financing for industry. And, indeed, the constitution of mixed conglomerates seemed to have served, in part, to improve these groups' internal

financing capacities. However, finance also answered the purpose to feed speculative activities, led to the constitution of complex corporate structures, and promoted fraud.

The available audit reports from after the Revolution point to the widespread use of financial fraud as a way to circumvent regulations on intra group debt exposure, to conceal the real purpose of holding companies (used to park personal property or to support patterns of luxury consumption), or to engage in hostile takeovers.

Data does not allow for a definite conclusion on this particular aspect, but there is evidence of growing financial fragility in the corporate sector, due to the circular nature of these companies' capitalisation. Portuguese conglomerates seem to have been highly leveraged, and most of the financing occurred within or between a small number of conglomerates, concentrating the financial risk.

In the 150 years under analysis, the process of accumulation and concentration of capital in Portugal corresponded to the accumulation and concentration of wealth and power by a handful of economic conglomerates dominated by specific families.

During this period, the interests of the Portuguese capitalist class were mostly determined by their rentist nature, which was rarely aligned with the ambition of developing the country's productive forces. And that explains why the lack of productive capital is so frequently pointed as one the Portuguese long-term structural weaknesses.

It is possible to argue that, given the historical conditions of the country, the Portuguese industrialisation was only possible through the protection and empowerment of the existing capitalist class. However, and regardless of the possible counterfactual debates on the industrialisation options for the country, the fact is that the real process did not break with previous patterns of rentism and dependency. And such type of accumulation regime was associated to excess capacity, inefficient productive structures and social backwardness.

Most of all, the dominance exerted by the conglomerates' strategies contributed to the consolidation of a structural distribution problem: on the one side, these profitable oligopolies and, on the other, the remaining productive structure, which remained poor, ignorant and underdeveloped, like the country.

This form of accumulation and concentration of capital was a continuous process, interrupted by the nationalisations programme in the context of the Carnation Revolution in 1974/1975.

During the 1980s, the integration in the European Union was pivotal in terms of shaping the rules of the new regime of accumulation, markedly neoliberal. The Lost Decade is the product of this regime which, despite differences, maintained some of the key aspects identified and analysed in this chapter, namely the patterns of rentism and dependency.

6. Neoliberal Accumulation: the re-creation of a capitalist class in the European Union

6.1. Introduction

In 1974, the Carnation Revolution introduced a radical change in the organisation of the Portuguese capitalist system. After a coup was attempted and failed (March 1975), the country's largest corporations were nationalised. The rural *latifundios* had been occupied, their owners expropriated. The previous process of accumulation and concentration of capital was interrupted.

The first measures aimed at reinstating the system of private capitalist accumulation, this time with neoliberal inspiration, occurred between 1979 and 1982. Their main purpose was to reopen stock markets and promote private investment. In 1989, three years after integration in the European Economic Community, an important Constitutional reform eliminated the principle of irreversibility of nationalisations, opening the door to the privatisations that followed. This reform and the whole body of legislation and policy decisions in place during the 1980s and the 1990s were crucial to the reconstitution of the Portuguese capitalist class.

The goal of this background chapter is to understand that process, finding common elements with the previous accumulation regime. Section 6.2 explores the transition from forms of organisation of property during the fascist regime to those of the nationalisations period. It describes the concentration processes in state-owned companies and the first liberalising policies.

Section 6.3 addresses the emergence of the first private economic groups. Most of these companies were unrelated to previous conglomerates, and still very far from the dimension and power that economic groups would achieve in the late 1990s and 2000s. The evolution in the Portuguese business structure during the 1990s is mostly explained by a political decision to reinforce and reorganise the capitalist class. As explained in section 6.4, the chosen strategy involved, on one side, attracting old exiled capitalists

back to the country and, on the other, promoting new emerging fortunes. The instruments were the privatisation of previously nationalised and concentrated companies and the development of stock markets. The concluding notes in section 6.5 argue that these were crucial elements in the reinstatement of a rentist capitalist class, whose interests contributed to create stagnant tendencies in the Lost Decade.

6.2. From private to State-owned to private: concentration policies

On the aftermath of the 1974 Revolution, the disruption of fascist and capitalist structures was total. The powerful bourgeoisie, linked to the oligopolistic sectors, was too dependent on the regime to survive without it or to lead the economy in a different path. The main families either escaped the country or attempted right wing coups to reinstate a more favourable state of affairs. It was understood that their economic and political power constituted a risk to the revolutionary process: ‘social classes which are the cornerstone of fascism remain intact through the economic power of banks, the corrupt ... who are agents of foreign imperialism’ (Mário Soares in *Diário de Notícias*, May 3rd, 1974).

Nationalisation processes, as well as agrarian reform, started in 1975. Nationalisations were not justified merely on ideological grounds, but also to overcome the abandonment of productive structures, prevailing situations of underinvestment, workers’ rights abuse or even sabotage and diversion of funds by its previous shareholders (Noronha, 2014). As for agrarian reform, it aimed to solve the old problem of land ownership, mostly in the south, where large properties were occupied by impoverished peasants.

The banking and insurance sectors were the first to be nationalised, in March. In April, Decree-Law 203-C/75 invested the State with enough powers to control the main economic levers. In the same period, the government nationalised key industrial sectors – steel industry, electricity, fuel, petrochemicals, chemicals, tobacco, paper pulp, beer and fertilisers —, transport companies — airlines, urban and maritime transports – and communications.

With the nationalisation of banking and insurance sectors, the State ended up controlling multiple shares in other companies. Foreign capital was respected in this process, creating some companies with mixed capital from State and foreign enterprises. On total, in 1977, the State owned a share in more than 1300 companies (Pintado & Mendonça, 1989).

Up to their privatisation, these companies were reorganised and controlled by the newly created *Instituto de Participações do Estado* (IPE). To simplify and optimise the management of such a complex and vast shareholdings portfolio, the government opted for a strategy that reinforced previous levels of concentration in the Portuguese economy. Banks and insurance companies were merged, and the industrial companies, which were already operating in oligopoly, were grouped in large sectoral holding companies: nine banks instead of 17; four insurance companies instead of 14; eight industrial holdings aggregating 32 companies; and 14 services and transport companies were merged into three units (see Tables Ap. 2 and 3 in the Appendix).

By 1978, state-owned companies accounted for 30% of the value added in terms of GDP, for 30% of gross fixed capital formation, but only 6,5% of total employment. These shares reflected the prevailing economic structure: on the one side, big companies that concentrated a large part of the country's investment, profit and value creating capacity; on the other, a multitude of small, familiar units, where most of the employment was located.

The Decree-law 46/77, published in 1977, established the limits and forms of private economic initiative. The law was written according to the Constitutional precept determining the irreversible nature of nationalisations, but it implicitly recognised the legitimacy of private ownership, opening the door for future changes. At the time, the State claimed the exclusive control of basic sectors, crucial to maintaining national sovereignty, or where there was the risk of excessive concentration of capital: banking, insurance, energy, water, communications, sanitation, transport infrastructures and services, armament, oil refineries, petrochemicals, fertilisers, cements and steel.

The Law 80/77 determined the compensation system for expropriations and nationalisations. If, at first, this compensation was limited in scope and value, its importance grew as governments liberalised the possible uses of public debt titles given as compensation. After the victory of a right-wing coalition in 1979, Decree-Law 344/80 admitted the exchange of such bonds for stocks of privatised companies.⁹⁰ Law 77/77 decided the return of occupied land to its previous owners, under a new Agrarian Reform. In the following years, other steps were taken to reconstruct the financial market,

⁹⁰ Alpalhão (2011) argues that the expropriated owners ended up with a relative gain vis-à-vis the previous situation.

liberalise external trade and eliminate industrial conditioning policies.⁹¹ Other laws were published aiming at the development of capital and financial markets and the promotion of private investment initiative.⁹²

In 1982, the first revision of the Constitutional Law, promoted by a sub-group of PSD⁹³, eliminated the most visible elements of its Marxist terminology and paved the way to private initiative. The argument was that the socialist principles that informed the Constitution were in direct contradiction with the European integration process. Nonetheless, the aspiration for a classless society in transition to socialism was reinstated. In 1983, Mário Soares forms a new government, but this time with PSD, implementing a draconian austerity programme under the direction of the IMF. In that same year, Law 46/77 was changed to allow the private ownership of banks and insurance companies, and quickly the sector started to grow.

In January 1985, Portugal signed its request to join the European Economic Community (EEC). Cavaco Silva, leader of PSD, won the general election, governing in minority. Two years later, he formed a new government, this time with absolute majority, assuming the total rupture with the socialist inspired principles of the Revolution and his preference for a liberalised economy. The official integration in the EEC happened in January 1986. That was year the European Single Act was signed by 12 countries, establishing a single European market for goods, services, capital and people. The European integration process was, at the same time, the political excuse and institutional materialisation of the liberal turn in the country. It legitimised policies of fiscal discipline, liberalisation in the context of the new competition rules, and the dismantling of labour rights.

In 1988, Law 84/88 opened the legal door for forthcoming privatisations, even before the Constitutional Review of 1989. State companies became public limited companies under public ownership, and its capital could be privatised up to 49%. Law 11/83, published in 1983, had already brought the State exclusivity in banking, insurance, cements and fertilisers to an end. From 1988 on, this list also included oil refining activities, petrochemicals, steel, electricity and gas, and communications.

⁹¹ Elimination of industrial conditioning: Decree-Law 145/49; Financial deregulation: Decree-Law 135/79; Decree-Law 171/79; Decree-Law 136/79; Decree-Law 137/79; Decree-Law 145/79.

⁹² Decree-Law 342/80; Decree-Law 494/80; Decree-Law 162/81; Decree-Law 253/82.

⁹³ *Partido Social Democrata*, the centre-right party in the Portuguese system.

The 1989 reform of the Constitution eliminated the principle of irreversibility attributed to nationalisations. The subsequent review of 1997 substituted the term *collective ownership* for *public property* and opened all sectors to private initiative.

In 1987, before the first privatisations, the Portuguese business landscape was divided in three groups: i) large state-owned companies, resulting from the concentration strategy described above, dominating heavy industrial areas, fuel, electricity, chemicals and the financial sector; ii) private companies, predominantly in the construction or traditional manufacturing industries and iii) foreign companies that controlled more technological sectors. The privatisations that started in 1989 changed this landscape and were the first step in the new phase of private accumulation by large economic conglomerates.

6.3. Emergence of first private groups

The first groups to emerge in the 1980s, before the privatisations, were very far from the dimension and economic power of the private conglomerates dismantled in 1974. The direct link between the financial and non-financial sector had been broken when the State assumed control of the banking system, and the access to subsidised industrial sectors operating in monopolistic or oligopolistic conditions was denied to the private initiative. These constraints, combined with growing incentives to the development of capital markets, determined the growth path of the new emerging groups: away from industrial sectors and based on the stock market to diversify their investments, frequently lacking a visible strategy in the process.

Table 7 lists the eight main private groups in the second half of the 1980s. Apart from BES (Espírito Santo family), these were mostly emergent fortunes, according to the pattern already described. In the following years, large-scale privatisations would change this picture completely utterly.

Table 3 - Main economic groups, 1985 - 1990

	Group	Assets	Equity	Turnover	Workers
1	Salvador Caetano	8.809.053	797.627	2.725.920	1.271
2	Vaz Guedes	8.058.991	704.945	2.258.667	568
3	Amorim	4.974.779	2.437.819	2.541.904	644
4	Sonae	1.424.810	1.791.853	3.298.874	1.465
5	BES	2.228.698	1.003.887	1.280.608	337
6	RAR	1.271.227	865.032	2.336.711	1.833
7	COLEP	2.460.107	485.036	1.321.455	1.069
8	S.N.S	1.424.810	343.485	2.076.303	2.933

Source: Caeiro (2004, p.492). Note: average values in constant prices (1976=100).

Salvador Caetano started in the 1960s assembling Toyota vehicles and operated mostly in the car trade business. Its growth was fast. Although remaining mostly in the car sector (79.5% of the total turnover in 1987), the group also owned a 30% shareholding in the largest construction company in the country – Soares da Costa SA. –, besides some investments in real estate (Pintando e Mendonça, 1989).

The Vaz Guedes Group's origins lie in a construction company created in 1947 with the Moniz da Maia family. The group developed around two main companies, Somague and Mague, specialised in heavy metalworking and public works. In 1987 Somague launched an Initial Public Offering, following an expansion strategy that also included several speculative financial participations (Pintando e Mendonça, 1989), namely in financial, insurance and hotel management activities (BCP, BPI, *Companhia de Seguros Garantia*, *Ocidental Seguros*, *Hoteis Tivoli*).

The Amorim family had a long history in cork production. It grew significantly in the aftermath of the Second World War, thanks to high cork prices in international markets (Pintado and Mendonça, 1989, p.56). By the 1960s, the Group had already some level of vertical integration, based on two main companies: Amorim & Irmãos, Lda (dedicated to the production of cork stoppers) and *Corticeira Amorim* (cork granulates and

agglomerates, as well as semi-finished and finished cork). That strategy continued in the first years after the Revolution, together with the rapid internationalisation of its activity.⁹⁴ In 1982 the Group created Champcork — *Rolhas de Champanhe S.A.* dedicated to the production of champagne cork stoppers.

Due to its familiar essence, common in many traditional economic groups, the Amorim group did not take advantage of the momentum in the Portuguese stock market in 1986/87. It had to wait until 1988 to launch an Initial Public Offerings for four companies: *Amorim & Irmãos S.A.*, *Corticeira Amorim Indústria S.A.*, *Ipocork – Indústria de Pavimentos e decoração, S.A.*, *Champcork – Rolhas de Champanhe S.A.* The several companies were consolidated under *Corticeira Amorim SGPS, S.A.* With the income from the stock market operation (PTE 4,3 billion), Amorim expanded by increasing his portfolio of financial participations.⁹⁵ Outside the scope of its main activity, the group's diversification had a case-by-case nature. Amorim participated in the constitution of *Sociedade Portuguesa de Investimento* (later *Banco Português de Investimento – BPI*) in the early 1980s, was the main individual shareholder of *Banco Comercial Português* (BCP), acquired 42,3% of Bank of Lisbon International (South Africa) and 20% of *Sociedade Portuguesa de Leasing*. In the industrial sector, it bought 30% of Mabor, 66% of Veldec and the majority of Silvicorte.

The Sonae Group is centred around Belmiro de Azevedo, who began as a worker and manager of the firm, which belonged to *Grupo Pinto de Magalhães*, dismantled in 1974. During the nationalisation period, Belmiro de Azevedo became the main representative of Afonso Pinto de Magalhães in the country. In the early 1980s, the previous owner of Banco Pinto de Magalhães (integrated in *União de Bancos Portugueses*) returned to the country, recovered several companies, including Sonae, and offered Belmiro de Azevedo a participation of 16%. Making use of a loan of PTE 100 million, Belmiro accompanied several Sonae capital increases, diluting the Pinto de Magalhães heirs' position.⁹⁶

Starting as a company dedicated to the production of decorative laminated products, Sonae's diversification strategy started in the 1980s, with interests in construction (Contacto), restaurant and hotel management (Ibersol), distribution and retail (*Sonae*

⁹⁴ In 1978 the Group founds *Portocork International, S.A.* (production of cork stoppers for exporting) and *Ipocork – Indústria de Pavimentos e decoração S.A.* (parquets, floor and wall covering).

⁹⁵ Pintado and Mendonça (1989) and Costa et al. (2010).

⁹⁶ 'There was a bank that, in a quasi-miraculous way, lent me a lot more money than I thought someone would lend me.' (Belmiro de Azevedo in *Diário Económico*, 22 April 2005).

Distribuição - Continente), some industrial activities (Aglom, Spanboard), real estate and shopping centres (*Sonae Imobiliária*) and media outlets (newspaper *Público*). In 1983 *Sonae Investimentos, SPGS, SA* was founded to be the main holding company, entering the capital market with a stock market capitalisation of PTE 500 billion. Above it was Figest, Belmiro de Azevedo's personal holding, and underneath it, five holding companies in strategic areas: distribution and retail (*Sonae Distribuição*), real estate, tourism and services (*Sonae Imobiliária, Tourism and Services*), agro-industry and biotechnology (*Sonae Agroindustria e Biotecnologia*), informatics (*Sonae Informática*) and international trade (*Sonae Trading*).

The stock market was an important source of growth for Sonae between 1985 and 1987. By 1989 Sonae was already the largest private economic group in the country (Costa et al., 2010; and Pintado and Mendonça, 1989).

The origins of the family-based *RAR – Refinarias de Açúcar Reunidas* Group, founded in 1962, lie in the sugar refining business. In the 1970s, its expansion privileged other agri-food activities (wine production, distillation activities), transport and trading of goods. In 1978 the group participated in the creation of *Sociedade Portuguesa de Investimentos* (later transformed in *Banco Português de Investimentos*), and, in 1981, it founded its main holding company *RAR – Sociedade de Controlo*. Apart from its core business, the group invested, during the 1980s, in the financial and banking sector (*Banco de Comércio e Indústria, Sociedade Portuguesa de Capital de Risco, RAR – Sociedade de Investimentos, RAR – Sociedade de Capital de Risco*), in tourism and hotel management activities (*Maestro – Serviços e Gestão de Hotelaria*), in real estate (*RAR Imobiliária*) and health care services (*Medicals*).

COLEP – Companhia Portuguesa de Embalagens started as a packaging company in 1965. Until the 1990s, *COLEP* remained a limited company, owned directly by Ilídio Pinho, and acted as the group's holding company. Its diversification was in part motivated by excessive capacity in its traditional sectors of activity – plastic and metal packaging and chemical products. Its investments were mainly in goods transport and trade activities (*Transinsular – Transportes Marítimos Insulares SA, TMI – Transportes Maritimos Internacionais SA, T&M Agencias de Navegação SA, Colep Trading Comercio Internacional Lda*), financial, insurance and banking services (*IP Financeira – Sociedade de Investimentos SA, COLEP Inova – Sociedade de Capital de Risco SA, Global – Companhia de Seguros, Global Vida – Companhia de Seguros, BCP, BPI, Geofinança,*

Lusitania Seguros), real estate (Imovalor, Mundicenter), gas and electricity (Emporgas, *Nacional Gás*, *Companhia de Electricidade de Macau*), and telecommunications (*PTC – Projectos de telecomunicações*). Pintando and Mendonça (1989) emphasises the role of a ‘speculative portfolio’ of participations as a substitute for direct market financing through, for example, IPOs:

‘The COLEP group “collected” several billion PTE in more or less anonymous transactions carried out on the stock Exchange. Examples include, among others, the sale of 14,300 shares of BCI – *Banco de Comércio e Industria*, to the RAR Group in October 1988, an operation involving approximately PTE 1 billion. The policy of selling small lots of the “speculative portfolio”, being more discreet and time-consuming than traditional IPOs, has the advantages of no failure risk or advertising costs. When well conducted, as has been done by COLEP, this policy is able to build an efficient alternative to traditional public offerings of shares, which necessarily involve large amounts of securities.’ (p.74)

Finally, SNS – *Sociedade Nacional de Sabões* Group started as a soap producing company in 1919 and grew into the agri-food (Sovendal and Vitamealo) and chemical (Sonadel, Sovena, Induve, Previnil) sectors, mostly in partnership with the CUF Group. Contrary to the remaining private groups analysed, SNS remained, at this point, mostly focused on its traditional areas, at the expense of its own growth. The exception was Sojornal and Gesco, two companies in media and communication sectors.

Except for SNS, all the remaining groups share some characteristics that gained importance throughout the 1990s: first, their relationship with the stock market, not only taking advantage of good market conditions to engage in highly inflated IPO, but by keeping a considerable speculative portfolio — this portfolio was usually composed of non-strategic shareholdings, often in the banking sector; second, their growing interest in non-industrial areas. As living conditions improved with the democratic establishment of the Welfare State and labour rights, these groups came to specialise in retail activities, tourism and real estate. As it will be shown, public investment in infrastructures, financed through European funds, also encouraged the rising interest in construction and public works.

6.4. Privatisation, liberalisation and stock markets: the same strategy

The reconstitution of the Portuguese bourgeoisie happened between the 1980s and the 1990s.

New groups emerged from medium-sized enterprises, excluded from nationalisations. These groups took advantage of the recently liberalised markets in the context of the international stock market boom between 1985 and 1987 and explored growing business areas outside the State's direct control: real estate, construction, distribution and wholesale, tourism. Even those groups traditionally focused on a specific manufacturing activity frequently expanded without a structured or visible business strategy. Their growth was determined more by momentary market opportunities than by a long-term industrial plan as such.

Nevertheless, the main beneficiaries of the large privatisation programme were the traditional family-based conglomerates. In time, these groups also ended up following the same short-term dispersion strategy, as they kept their traditional links to finance and some industrial activities, but soon entered the real-state, construction and distribution sectors.

The Lisbon Stock Exchange appreciated 84,62% between February 1983 and October 1987 (Mata, Costa & Justino, 2017). This unprecedented boom was caused by national dynamics, namely, the excessive speculative demand for securities in face of a still weak supply. From 1980 to 1985, the number of listed companies increased 184%, from 25 to 46; yet its share capital increased by more than 1000%, and 93% of it was concentrated in the ten largest companies. The European Economic Community integration process, completed in 1986, reinforced the generalised optimism, but could not avoid the crash in 1987.

Abílio de Sousa, the oldest broker in Portugal, described the 1980s' boom as years of euphoria, leveraged on bank debt:

‘It was the time of the OPV (Public Sales Operations). Banks lent money with almost no collateral. Hence, the existing excess liquidity was channeled into the stock market, originating OPV prices that were completely distant from reality. Security prices had nothing to do with the actual situation of companies. (Abílio de Sousa in *Público*, 19th October 2007)

After the 1987 crash, the Lisbon Stock Market entered a five years' period of dismal activity, reflected in the negative behaviour of its main index (-5,66% between 1987 and

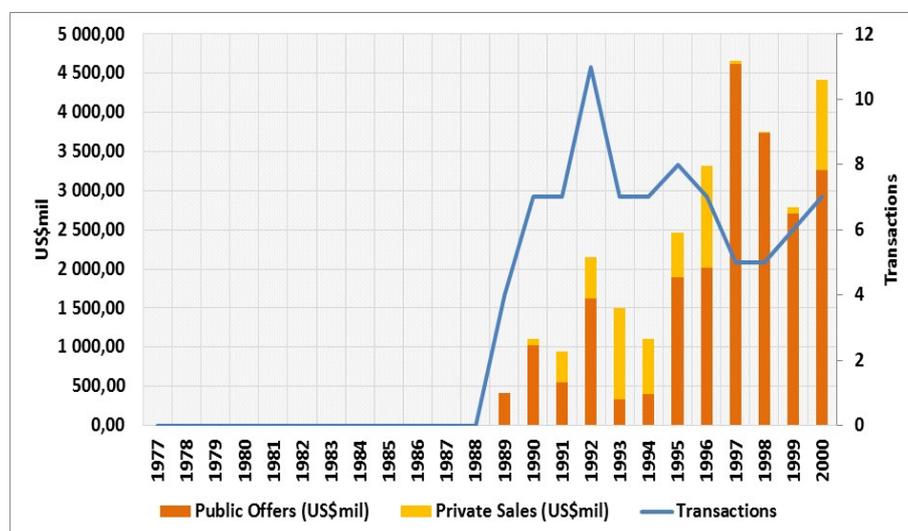
1993). The privatisation programme established with the Constitutional Reform of 1989 and the Privatisations Law of 1990 aimed at both the recovery and development of the stock markets and the reconstitution of the Portuguese traditional business class⁹⁷. These intentions were openly stated by the Prime Minister in 1989:

‘... at the same time, we will have to promote economic groups in Portugal. These were destroyed at the time of the Revolution, with nationalisations. We need them because, otherwise, foreigners will come to control our companies and the economic strategy will be determined from the outside.’ (Euromoney, 1988)

Miguel Cadilhe, Minister of Finance, also admitted in 1991: ‘Let us be clear. The objective is to foster and strengthen the Portuguese capitalist class through privatisations’ (in Costa & Mortágua, 2015, p.21).

Consequently, between 1989 and 1995 the Portuguese State was the third largest privatiser in the OECD, with revenues around 9% of the GDP (see Figure 20) (Baklanoff, 1996, p, 942).

Figure 20 – Privatisations’ revenues



Source: Privatisations barometer.

⁹⁷ Until 1993, the government’s strategy to favour national capital was translated into upper limits for foreign participation in the newly privatised companies. However, this practice was in direct conflict with the competition principles established in the European Union Treaty. From 1993 on, the distinction between foreign and national buyers disappears from the privatisations legal framework, although the Minister of Finance maintained authorisation power for very investment above 10% of the selling company.

The privatisation process, started in 1989, followed several principles. There was, as mentioned, the explicit objective to nurture the Portuguese capitalist class, ousted out in the Revolutionary process. In practice, this objective was in contradiction with the idea, assumed in the privatisation's law of 1990, that the capital of newly privatised companies should be dispersed between workers, the public and capital markets. Despite the rule limiting the shareholder power of single investors, the fact is that the privatisation methods deployed (selling the stocks in blocks, by bookbuilding or public tender) favoured the concentration of shares in the hands of specific economic groups.

The collective negative appreciation of pre-Revolution economic conglomerates was now openly challenged, supported by the argument that only large economic groups could ever compete in external markets, and that privatisation should promote those type of organisations. Belmiro de Azevedo, owner of Sonae, one of the leading businessmen of the new democratic era, was clear in this respect:

‘Only through links between industrial and financial groups can this dimension be attained ... the government has an exceptional opportunity to encourage the creation of such groups if, rather than authorising, it has a privatisation policy that favours cross-ownership.’ (Azevedo, 1993, pp.23-24)

At the same time, there was an explicit political movement to promote the return of former capitalists. There are plenty of reports of several meetings between António Champalimaud, Jorge de Mello, Ricardo Espírito Santo Salgado and the ministers of finance of the privatising governments. In some cases, like Champalimaud, the return was agreed upon generous financial compensations or legal amnesties for past lawsuits (Amaral, 2015, p.81). In other cases, like the Espírito Santo family, the prime-minister took it on himself to find foreign partners that would support their return⁹⁸.

This strategy faced obvious difficulties, mostly related with the lack of dimension and financial capacity of, on the one hand, the existing economic groups and, on the other, the exiled capitalists (Mendonça & Pintado, 1989). Two other aspects occupied the political and theoretical debates on the subject: the financial and economic viability of some of the public companies and the particularities of privatising natural monopolies.

The combination of responses to these principles and constraints determined the path and forms of privatisation.

⁹⁸ Mário Soares, the prime-minister, agreed with François Mitterrand, the French President, the support of State bank Crédit Agricole to the financial projects of the Espírito Santo Group and it bought a stake at the group's bank.

The first step was to determine which companies could be immediately privatised, with a large and rapid potential of return to its buyers. There was also the need to find financing mechanisms to support national economic groups by instituting compensations for nationalisations and reconstituting the stock market. The privatisation law of 1990 clearly stated that previous compensations in the form of public debt could be mobilised to pay for privatisation operations.

Together, privatisations and the development of financial markets were two sides of the same political strategy.

Hence, the stock market was used as preferred means of privatisation: between 1989 and the beginning of 1995, privatisation operations represented 74,3% of the total transactions in special stock market sessions (GAFEEP, 1995, p.224). While in 1989 privatised companies represented 2,9% of total market capitalisation, in 1995 their share was already 36,7%. Besides the quantity effect, there was also a price effect in the privatisation strategy, ‘resulting from the low prices offered by the government in the initial sessions of privatisation – providing easy and rapid capital to the common investor — together with the restored involvement of foreign investors in the market’ (Mata et al., 2017, p. 148).

In 1995, the Ministry of Finance concluded that ‘the privatisation process contributed unequivocally to the development of the shareholder market, both in terms of size and liquidity’ (GAFEEP, 1995, p, 240).

In fact, between October 1993 and March 2000, the Lisbon Stock Exchange Index gained 24%. The share of market capitalisation in percentage of GDP increased from 0,90% in 1985 to 15,57% in 2000, representing a local maximum, interrupted by the *dotcom* bust of 8th March 2000. This increase was not a sign of the corporate sector’s more generalised access to capital markets. The total number of listed companies increased from 46 to 191 between 1985 and 1990. This increase is the result of the intensive privatisations programme in those five years (147 operations). However, that number decreased again to 110 in 2000, due to the ongoing wave of mergers and acquisitions and the impacts of the *dotcom* crisis on the communications market. In the year 2000, the ten largest companies represented 72% of the total share capital (Table 7), showing, once again, signs of a very concentrated structure.

Table 4 - Lisbon Stock Exchange, 1977 - 2000

	1977	1980	1985	1990	1995	2000 (€)
Listed corp.	35	25	46	191	169	110
Total Share Capital (PTE000000) (Eur000000)	2.661	3.686	37.314	502.249	1.471.316	17.990
Share of the 10 largest corp.	82,1%	84,1%	93,2%	41,9%	42,4%	71,8%
Share of the 50 smallest corp.	-	-	-	3,8%	2,1%	2,5%
Share of capital in % GDP	0,37%	0,25%	0,90%	4,99%	9,25%	15,6%

Source: Mata et al. (2017, p.226).

As in the past, the stock market was an instrument for speculation and a source of funds for the largest companies, but it did not serve the general purposes of financing the overall investment activity.

Another way to ensure that the market was sufficiently liquid to support the privatising strategy was to prioritise the selling of state-owned financial companies. Insurance companies were sold first. Using its funds, economic groups could leverage their position and run for the privatisation of banks, which, in turn, could increase the leverage capacity to engage in other operations:

‘You buy an insurance company, which requires a smaller investment, and then this company, with its own resources, or through debt, moves to the privatisation of the bank that interests the group, and whose property costs a pretty penny. The government was not distracted when it allowed this amateur’s trick. There were several photocopies.’ (António Almeida, former president of *União de Bancos Portugueses*, in Costa and Mortágua, 2015, p.28)

Two of the four first companies to be privatised were insurance companies (*Aliança Seguradora* and *Tranquilidade*). The others were a bank (*Banco Totta & Açores*) and a beer company (Unicer). After the Second Constitutional Review of 1989, several other

companies were sold, mostly in the financial sector. There was the general understanding that the private sector did not have the financial capacity to invest in most of the large industrial companies, since some of them were also in a fragile financial situation.

Mira Amaral, Minister of Industry and Energy between 1987 and 1995, identified three strategies to deal with industrial privatisations (Amaral & dos Santos, 1995). In some cases, companies had to be restructured first, financed by the State and then sold. In other cases, corporations were transformed in holding companies owning several independent companies which could be privatised separately, according to the interests of the buyers (Quimigal, Portucel, *Siderurgia Nacional*). Finally, when private investors were not interested in the ownership of the privatised company, the solution was to sell the concession of its management. Private investors usually owned the right to execute a buying option in the future (Setenave and *Companhia Nacional de Petroquímica*).

From 1987 and until 2006, the State privatised 164 firms in 239 operations, usually operated through the stock market (Mata et al, 2017, p. 148).

The ongoing process of financial liberalisation and economic deregulation resumed the legal and practical conditions for private accumulation.

In 1983, Law 11/83 authorised the formation of new private financial institutions (banks, insurance companies and other non-monetary institutions, investment and venture capital companies). To promote the development of the stock market, virtually inexistent since the Revolution, the government published several diplomas creating incentives to issue new shares. Among other tax measures, interest rates on shareholders' loans to increase their capital participation in the form of stocks started being deductible as costs. Furthermore, 'the Minister of Finance himself took the initiative to write a letter to many local firms inviting them to consider the use of the capital market and the listing of their shares' (Mata et al, 2017, p. 263).

Decree-Law 495/88 regulated the establishment and functioning of holding companies. Its goal was very clear:

'The goal of the single European market, to be achieved as soon as 1992, requires, however, other more significant steps to create favourable conditions, notably of tax nature, to facilitate and encourage the creation of economic groups as appropriate instruments to contribute for the strengthening of the Portuguese business fabric.' (Decree-Law 495/88)

Besides tax benefits, the new regime facilitated credit operations between same group companies. It was, therefore, a legal framework adapted to the financial needs and characteristics of the business class. As in the past, the pyramidal structure that resulted from the model of holding companies functioned as a capital-saving mechanism, favouring corporate control strategies based on complex debt schemes. In 1989 this law was complemented by the Statute of Tax Benefits (Decree-Law 215/89, of June 1st) establishing, amongst other advantages, lower levies on dividend distribution and corporate tax exemption for real estate investment funds.

6.5. Final remarks

The purpose of the present chapter was not to examine the specific strategies of accumulation and concentration of capital under the neoliberal regime or their relation to sabotage. That is the purpose of Part III and, in particular, of chapter 7. The aim of this background chapter was to understand the elements that explain the particular configuration of the Portuguese capitalist system after this transition period in the 1980s and 1990s.

It was demonstrated that, likewise in the past, the constitution of a capitalist class was a political decision. It is also interesting to note how the political and social narrative built to justify these policies recovered some of the previous arguments. The empowerment of newly formed as well as old capitalists was presented as the pre-condition to provide the country with a modern and competitive productive structure, based on national centres of decision. The need to compete in the common European market, and to comply with new competition rules set by the European Commission was the new but very powerful element in this narrative.

As in the past, the transition from small family-based businesses, usually located in the manufacturing sector, required two conditions: access to finance – either by controlling banking institutions or through stock market operations – and access to monopoly profits, in this case via the privatisation of large state-owned companies.

However, unlike in the prevailing accumulation model before the Revolution, this time there was no attempt at all to control the organisation of the industrial system. The prevailing form of industrial policy was deregulation and liberalisation of most financial

and economic activities, with no intention to direct rents to specific manufacturing sectors.

In Part III, it will be shown that such policy choices were to a great extent responsible for the establishment of a capitalist class based on the exploitation of rentist or protected activities and consumed by internal disputes for political and economic power. A capitalist class whose accumulation and concentration strategies constituted forms of sabotage, from the point of view of the country's economic development. The overall result was not, as announced, the improvement of the country's productive forces, or even the maintenance of national decision centres. On the contrary, the result was the overdevelopment of specific activities – finance, utilities, construction and real estate –, associated to the channelling of large public funds to big economic groups. Additionally, prevailing unbalances in distribution of profits, investment and employment in the corporate sector were not structurally solved. These aspects are important causes for the stagnant Portuguese economy during the Lost Decade and slow recovery after the crisis.

PART III: STAGNATION IN THE LOST DECADE

7. The Portuguese rentist economic structure

7.1. Introduction

In the preface to the fourth edition to *Economia Portuguesa*, published in 2013, Abel Mateus suggested – without further development - an unusual explanation for the Portuguese situation of ‘almost stagnation’ in the 2000s. Mateus argued that this poor economic performance had a structural nature, related to the presence of powerful economic groups:

‘On June 12th 2002, we wrote an article for *Diário Económico* entitled “Why is the growth of Portuguese economy low”, in which we once again argued that the Portuguese economy was entering a phase of near stagnation due to structural factors. At the time, many economists claimed it was a temporary recession ... We believe much of the answer derives from reasons connected with political economy and the functioning of an incipient democracy in the presence of influential economic groups. Economic theory is now taking the first steps in this type of analysis.’ (Mateus, 1998/2003, p.7)

After the financial crisis and the subsequent recession, the lack of economic growth during the 2000s came to be widely recognised as a structural problem, instead of a

temporary consequence of the *dotcom* crisis in 2001/2002. A wide number of critical analyses highlighted the detrimental effects of financialisation and the flawed European monetary integration, put forward as important causes for that structural problem. Amaral (2010) provides a short explanation of the convergence (and divergence) process of the Portuguese economy, with a special focus on the Welfare State, employment and education. Paes Mamede (2015) summarises the main reasons for the disappointing economic performance since monetary integration, highlighting the impacts of the financial sector in the economy. Alexandre et al. (2014) put together several contributions on the economic transformations in the context of European Integration. More recently, Alves & Tavares (2017) discuss the role of the banking system in the country's economic evolution since the 1990s and argue that excess capacity and credit allocation decisions are important causes for the poor economic performance since the 2000s.

These analyses are not in any way refuted by the argument developed in this chapter. On the contrary, it has already been argued in chapter 6 how both these elements – the EU and financialisation – were pivotal in shaping the type of capitalist accumulation regime in Portugal during the 1990s and 2000s.

The purpose of this chapter is to put forward a political economy and institutional analysis of the structural weaknesses behind the Portuguese stagnation of the 2000s. The focus of this analysis is, as suggested by Mateus (1998/2013), the role played by large economic conglomerates in the context of the Portuguese democracy.

This approach is derived from the broader theoretical framework developed in chapter 4, in which stagnation is presented in the context of accumulation and concentration strategies of economic conglomerates. The main argument is that these strategies assume the form of sabotage, affecting the overall economic outcome negatively.

As shown in chapter 5, historically, the concentration and accumulation of capital by large economic groups is not determined within the production sphere. It is a cumulative process where family networks, political decisions and financial relations, amongst other factors, play a crucial role. Likewise, there is no invisible hand making sure that the strategic interests of large conglomerates are aligned with the generally shared ideals of economic growth or industrial development. On the contrary, the individual pursuit of profits and power can generate collective detrimental socio-economic effects.

The historical background in chapter 7 provides the starting point to understand the main characteristics of the accumulation regime which emerged in the 1990s. The privatisation of profitable monopolistic companies, the rapid development of banking and financial systems, the liberalisation of capital movements and trade flows in the context of monetary integration worked together to shape the interests of a capitalist class that already had a background of dependence and rentism.

The analysis in this chapter explores the consolidation of that regime in the 2000s, beginning with identifying its main beneficiaries.

The blurriness of today's conglomerates raises real challenges in terms of measurement delimitation of economic groups. Given the lack of more complete databases, the choice has fallen upon the list of the largest economic groups in Portugal published annually by Informa D&B, complemented with companies listed in the Lisbon Stock Exchange. The latter was not the primary choice for two reasons: because important companies are still out of the stock market and because only individual companies are listed, and so the group perspective is lost. Annual reports and accounts are still the most complete source of information on each group. Still, it should be noted that these official documents exclude important information on corporate financing and economic strategies. Since *Banco de Portugal* archives are not available for the most recent decades, official information was complemented by journalistic sources and the archives of several inquiry parliamentary committees.

By using original and alternative sources of information, this investigation provides a unique contribution to the history of economic conglomerates in Portugal, including their accumulation and concentration strategies and its consequences.

This chapter starts with the mapping of the evolution of the Portuguese largest companies and economic groups in the 1990s and 2000s. Section 7.2 describes the transformation the Portuguese private business structure went through, from the small traditional groups described in section 6.3 to the consolidation of large corporations and economic groups, based on four main sectors: privatised monopolies in the utilities sector, retail, construction and banking. The following sections explore the main elements that have contributed to this transformation.

Section 7.3 follows the privatisation process of the largest state-owned monopolies, and their evolution under private management. It is therein evinced that these companies'

profit generation capacity, as well as their strategic position in the economy, were crucial to the accumulation strategies of Portuguese capitalists. Section 7.4 explores a sub-process of the privatisation programme, namely the public-private partnerships (PPP). These contracts — transferring the financing and execution of public investment projects to private counterparts, in exchange for future payments — are yet another type of rentism, highly beneficial for banks and construction companies.

Section 7.5 focuses on the banking sector and its strategies to overcome declining interest margins in the context of the European monetary integration. As shown, these strategies contributed to a situation of indebtedness and low fixed investment. Section 7.6 is dedicated to non-banking economic groups, identifying their growth strategies and areas of interest. Section 7.7 concludes, arguing that all these elements worked together to create an overall structure of incentives that gave form to a specific regime of capitalist accumulation which was contrary to productive investment and growth.

7.2. A short presentation of the country's largest groups and their evolution

Tables Ap. 4-9 in the Appendix list the largest banks and non-financial companies in the country in 1994, 2000 and 2007, as well as their sectors of activity and main shareholders. These rankings, based on the D&B database, do not always distinguish between individual companies and economic groups. The disperse character of the latter, usually constituted as a net of holding societies with a myriad of strategic and speculative shareholdings, makes it very difficult to have a clear idea of the real dimension and shape of Portuguese economic groups.

Notwithstanding, these lists disclose substantial features of the Portuguese business structure. First, as expected, the banking sector dominated the economy. By the year 2000 some important banks had disappeared or merged into other institutions, as the privatisation process was completed (apart from *Caixa Geral de Depósitos*). Traditional families, like the Champalimaud and the Espírito Santo consolidated their power in the banking sector, competing with rapidly growing private groups – BCP and BPI.

By 1994, the State remained the main owner of some of the largest companies in the country. Most of these companies were still operating in a context of monopoly or oligopoly in strategic industrial or utilities sectors: Petrolgal (fuel), *Comunicações Nacionais* (telecommunications), Cimpor (cements), Portucel (paper), *Tabaqueira*

(tobacco). Six years later, these state-owned companies occupied important positions in the list: Portugal Telecom (communications), Petrolgal (Fuel) EDP (electricity), TAP (Airlines), Portucel (paper), CTT (Mail services). With some exceptions, all these companies were already mainly private or in the process to be privatised by 1999. The direct transfer of economic and market power from the public to private groups will be analysed next.

Apart from the banking sector and privatised companies, the two largest non-financial groups — Sonae and Jerónimo Martins — were mostly focused on wholesale and retail activities. The Amorim Group was the only originally private group with an industrial nature (cork sector), but with several incursions into other areas, like tourism, finance and fuel (GALP). The Mello family returned to the list of the most important economic groups (although not on the top 25), but this time divided into two independent business conglomerates with diversified interests. Both lists name two other economic activities as relevant: car trade and retail (SAG and Salvador Caetano) and construction (Teixeira Duarte and Soares da Costa).

In the meantime, it should be noted that, until the 2000s, the presence of foreign capital in the country was important but remained concentrated on branches of multinational companies – Siemens, Shell, Renault, Nestlé. In the banking sector, Spanish Santander entered the Portuguese market by acquiring a previous existing institution – *Banco Totta & Açores*. That situation changed throughout the decade. As privatisations moved forward and previous regulations favouring the national ownership of strategic companies were removed, foreign ownership increased. This structural change took place both directly — via governmental decisions in privatisation operations — and indirectly, as participations previously owned by Portuguese shareholders were transferred.

In 2007, out of the 25 largest groups/companies, five were banks, three were retail companies, three were in car retail and assembling related activities, two were state-owned companies running the national airlines and post office services, and other two were important privatised companies, in the communications and energy sectors. The four manufacturing companies resulted from previous concentration processes during the nationalisations period, in the paper and cement sectors. The exception is Amorim SGPS. Finally, the list also contains two construction companies.

This sample of 25 companies and economic groups reflects the main characteristics of the complete list assembled by D&B Informa (120 companies). The predominant sectors

were finance, retail and wholesale, car retail, (tele)communications, real estate and construction, and some manufacturing activities. The novelty in the list of predominant economic activities is the growing number of companies specialised solely in construction or in the management of concessions and public-private partnerships (from 6 in 1996 to 13 in 2007). Usually, large groups combined several strategic and speculative participations in more than one sector, and the level of cross-shareholdings was large.

7.3. In the aftermath of privatisations — profitable private monopolies in the utilities sector

This section analyses in detail the privatisation processes and evolution of the main state-owned companies – Petrogal/GALP, Portugal Telecom, Cimpor and EDP –, in order to access their importance to private accumulation strategies.

Petrogal/Galp – Amorim's jackpot

In 1991, Petrogal, the state-owned holding company in the fuel sector, started to be privatised. Given the company's dimension, the government contributed to create a Portuguese consortium, including some of the most important economic groups and businessmen – Espírito Santo, Patrick Monteiro de Barros, José de Mello, Champalimaud, Manuel Bullosa, Américo Amorim, José Roquette, Parfil and STDP.⁹⁹ Together, these investors had 51% of Petrocontrol, the private holding which bought the first 25% of Petrogal. French group Total kept a shareholding of 49%. In 1995, after some years of financial difficulties, the government had to negotiate a new contract for the fuel holding. Petrocontrol increased its participation to 45% and obtained the option to purchase up to 51% while the State also contributed to recapitalise the company. The Portuguese consortium (Finpetro) acquired the French shareholding and dominated 38% of Petrocontrol.

In 1998/1999, the energy market was restructured.¹⁰⁰ Galp SGPS SA was created to aggregate all of the State's holdings in the gas and fuel sectors (Petrogal, *Gás de Portugal* and *Transgás*), with an initial capital of €411,4M, months later raised to €502,2M.

⁹⁹ The Oriente Foundation with Stanley Ho.

¹⁰⁰ Decree Law 137-A/99.

Galp's privatisation started in 1999, when the shareholders of Petrogal, *Gás de Portugal* and Transgás were invited to swap their shares.¹⁰¹ Petrocontrol kept a share of 33,34% of the new company, and the difference between established unitary prices of old and new shares was incorporated in Galp's initial balance sheet as a share issuance premium. The other relevant shareholders were EDP (3,27%) and *Caixa Geral de Depósitos* (2,75%).

In 2000, the new Minister of Economic Affairs, Pina Moura, changed the State's strategy in relation to the company. Instead of national shareholders – Petrocontrol – and State ownership, it promoted the direct sale of 15% to 'strategic foreign investors' – Iberdrola (4%) and ENI (11%) for €433,6M.¹⁰² Officially, the goal was to create a monopolistic company at the scale of the Iberian Peninsula.¹⁰³ Politically, the operation was subjected to parliamentary investigation and the arguments did not convince the majority of members of parliament.¹⁰⁴

With government's approval, ENI and EDP acquired Petrocontrol's share in GALP, becoming its largest private owners, with 33,4% and 14,26%, respectively. Petrocontrol realised a capital gain of €525M, the difference between its buying price in 1992 (€439M) and the selling price (€963M). Shareholders were exempt from any capital gains tax by an interpretative order of the Minister of Finance. The existing law exempted holding companies from capital gains taxes in the case of reinvestment in two years. In this situation, reinvestment was technically impossible given the dissolution of the holding company, Petrocontrol.

The new PSD/CDS government used the third privatisation phase to abort ENI's intents to control GALP, promoting a new concentration operation in the sector.¹⁰⁵ Therefore, in 2003, REN – the company running the energy transport network – acquired 18,3% through a direct sale from the State (4,8%) and *Caixa Geral de Depósitos* (13,5%). The new national strategy for the energy sector opened a long-lasting conflict between ENI

¹⁰¹ Decree Law 261-A/99, July 7

¹⁰² Council of Ministers Resolution 10-A/2000, 16th March

¹⁰³ 'The government's acts concerning the participation of ENU and Iberdrola in the capital of Galp are part of the implementation of a strategy of concentration, gaining size and privatisation of the energy sector as a whole.' (Pina Moura, Report from the Parliamentary Committee of Inquiry - *Para apreciação dos actos do Governo referentes à participação da ENI e da Iberdrola no capital da GALP*, SGPS. *Diário da Assembleia da República*, Serie II-B – N. 6, Thursday, 22 Saturday 2001).

¹⁰⁴ He stated that: 'as regards the strategy implemented for Galp, it is not likely a consensual explanation in the field of national interest or business rationality will be found, either based on exogenous, endogenous or any other factors.' (Report from the Parliamentary Committee of Inquiry)

¹⁰⁵ Decree-Law 124/2003, 20th June, and Council of Ministers Resolution N. 193-A/2003, 26th December: 'The Government takes the view that strengthening the entrepreneurial capacity of the national energy operators in the context of an increasingly open and competitive market, in addition to advising the integration of electricity and gas distribution activities, should be achieved through the integrated collection and exploitation of energy networks. The entry into the shareholder structure of Galp of an energy operator as the new Galp reference shareholder should therefore contribute in a relevant way to the pursuit of these strategic objectives.'

and the State. One year later, Pina Moura, the Minister that promoted ENI's and Iberdrola's participation in Galp, became CEO of Iberdrola and joined the board of GALP. The last important change in Galp's shareholder structure occurred in 2005, when Amorim Energy (a joint venture between the Amorim family – 55% - and the Angolan State-owned company Sonangol – 55%) acquired EDP and REN shares representing 33% of Galp's capital. The government had changed again, and the Socialist party justified the selling operation the State was the main shareholder in EDP and REN – with the need to prevent the foreign ownership (ENI) of the Portuguese fuel company.¹⁰⁶

Amorim's participation was expanded during the fourth privatisation phase, in 2006, when Galp joined the stock market in the largest IPO so far in the decade. The State sold 23% and kept special shares of 7%. After the operation, the main shareholders were *Amorim Energia* (33,34%), *Caixa Geral de Depósitos* (1%), ENI (33,34%), Iberdrola (4%), BPI (5%), and the Portuguese State (7%). By the end of 2007, the value of Galp stocks had increased more than 200% (see Figure Ap.1 in the Appendix), which means that Amorim's share was worth more €3.428M. In 2008, Iberdrola sold its share, with a gain of €370M.¹⁰⁷ Furthermore, the dividends received by Amorim in the first three years compensated for about 1/3 of the initial price of the participation.

Galp's valorisation reflected the general pre-crisis stock market euphoria, but also the company's fundamentals, shown in Table Ap.10 in the Appendix. Contrary to other large companies, Galp did not increase its indebtedness. The amount of financial investments was negligible and, apart from 2007, did not contribute to the overall net result. Despite important investments reported in the annual accounts, Galp's assets increased only by 14% between 2000 and 2008. In the same period, EBITDA improved by 100%, and its net results by 1.494%. The data suggest that, apart from some (foreign) and modernisation operations, Galp's main infrastructure was already set when the company was constituted. Its profitability, reflected in the value of dividends distributed (€1.136M between 2003 and 2008), derives from its operation, mostly in fuel related activities, where it is monopolistic.

According to Competition Authority's reports, Galp was responsible for 20% of the refining capacity in the whole Iberian Peninsula, and for 100% in Portugal, more than the

¹⁰⁶ Prime Minister José Sócrates told DN in 20/09/2009 that he acted: 'in a patriotic way to prevent Galp from passing – as was being prepared – to Italian hands.'

¹⁰⁷ 'Iberdrola vendeu hoje participação de 3,83 por cento na Galp' in *Público* (30th January 2008).

national market could absorb. In the first selling stage (directly from the refinery), Galp controlled 80% of national consumption of diesel and gasoline, 60% of natural gas, and more than 95% of Jet fuel. Its share in the retail market in 2007 was 38,4% in gasoline and 27,9% in diesel. Although fuel long-term average prices Portugal have not differed much from international average, a comparison exercise within the European Union showed that price downward adjustments are slower in Portugal (two to three weeks) relatively to other countries, while upward movements are quicker (one week). This behaviour is common in other operators in the country, suggesting signs of cartelisation in this oligopolistic market.

Portugal Telecom – Espírito Santo's cash cow

The communications sector went through a process of deep restructuring. As with the energy sector, several communication companies previously aggregated under CN – *Comunicações Nacionais, SGPS, S.A.* — were merged into the new State-owned holding Portugal Telecom, privatised between 1995 and 2000.¹⁰⁸

In the first stage, in 1995, the State sold 27,26%, divided in the following way: 38,2% to international investors, 8,6% in a direct sale to institutional investors and 52,2% in a IPO, which included the swap of private shares representing 49% of Radio Marconi, corresponding to 8,4% of Portugal Telecom (Portugal Telecom, Annual Report, 1995).¹⁰⁹

Its dimension made Portugal Telecom (PT) difficult to control and, therefore, not an interesting investment to national groups, apart from Espírito Santo. The group was already in the telecommunications sector through Telecel,¹¹⁰ the only private mobile communications company, and in Radio Marconi (5,9%).¹¹¹ By swapping its stocks, which were added to the participations of a George Soros investment fund and Caisse Dépôts, the family obtained enough voting rights to nominate one member of the Board of Directors.

¹⁰⁸ Telecom de Portugal S.A., Telefones de Lisboa e Porto S.A. , Teledifusora, S.A. and Radio Marconi.

¹⁰⁹ Portugal Telecom was the second Portuguese company to be listed in the New York Stock Exchange.

¹¹⁰ Shareholder structure: Amorim (31,25%), Espírito Santo (31,25%), Pacific Telesis International (23%), EFACEC, Centrel and LCC Eurofon.

¹¹¹ The 31,25% participation was owned by an intermediate holding, *Espírito Santo Irmãos*, located between Espírito Financial Group SGPS and ESI.

In 1996 and 1997, the Amorim Group and the Espírito Santo Group sold their share in Telecel (62,5%) to Vodafone, with significant profits.¹¹² The Espírito Santo Group chose to increase its participation in Portugal Telecom. Starting with a share of 2,7%, the group raised its participation to around 9,9% in 2000 (Annual Accounts, 2000).

The second stage of privatisation occurred in 1996, with the selling of an additional participation of 21,7%. By the end of the year the stocks had risen 22% relatively to the privatisation price and 57% compared to the previous year. One year later, the State sold another 38.000.000 shares (29%) and, after two other operations – in 1999 and 2000 –, its participation in Portugal Telecom was reduced to the 6,8% belonging to *Caixa Geral de Depósitos* and 500 shares with special rights. After privatisation, Portugal Telecom SGPS S.A.'s main shareholders were: *Banco Espírito Santo* Group, Telefónica and its related companies – Telesp Fixa, *Aliança Atlântica* Holding – *Caixa Geral de Depósitos*, Brandes Investment Partners, and BPI.

During the *dotcom* enthusiasm, in 1999, Portugal Telecom (PT) created *PT Multimédia*, to aggregate all participations in multimedia companies (*PT Conteúdos*, *TV Cabo*, *TelepacII*, *Páginas Amarelas* and *Portal Sapo*). Its dispersion in the stock market occurred in November. In March of the following year its price had increased from €27 per share to a maximum of €146. The same strategy was followed with the creation of PTM.com (which held the participations of Lusomundo, *ZIP.net*, *Banco.net*, *Sapo* and *Infodesporto*). After the *dotcom* bubble bursted, PTM.com was delisted from the Lisbon Stock Market and its shares swapped for *PT Multimédia* stocks, whose capitalisation decreased from €11.6 to €7 billion.

Meanwhile, PT was determined to increase its international activity and selected Brazil as a privileged investment outlet. In 1998, it acquired 19,6% of CRT (*Companhia Riograndense de Telecomunicações*) for PTE 96 billion, and, in the same year, it also acquired the control of Telesp Celular and a participation in *Telest Fixa* in the privatisation of Telebrás for PTE 570 billion.¹¹³ These investments were made in a strategic partnership with Spanish Telefónica, in which Portugal Telecom had a shareholding of 1% since 1997. In the following two years the company created *Medi Telecom* (Morocco), *Mascom* (Botswana), bought CETERP (Brazil), Global Telecom

¹¹² According to Neves (2017) and Ferreira (2017) the license was obtained with an investment of €15M and the participation was sold for 100 million.

¹¹³ 51,8% of voting rights and 19,3% of the capital of *Telesp Celular Participações S.A.*, which holds 71% of Telesp Celular for 563 b in <http://pharol.pt/pt-pt/press-releases/noticias/Paginas/1998/com29071998.aspx>.

(Brazil), the communications networks of Bradesco and Unibanco, Lusomundo (Portugal), *ZipNet* (Brasil), UNITEL (Angola), and increased its participation in Telesp (Brazil). Between 1998 and 2001, Portugal Telecom spent €6.465M in financial investments (compared to 237 million in the previous three years), with a corresponding increase of 370% in net debt. In 2000, the group was restructured and PT S.A. became PT SGPS, the group's control holding company, structured on the basis of five fields: i) landlines and domestic Internet business (PTC, PT Prime, PT Corporate and PT.COM); ii) mobile communications in Portugal (TMN); iii) multimedia business (*PT Multimédia*); iv) international business and v) instrumental companies.

PT¹¹⁴ also acquired a 2% share of BES (*Banco Espírito Santo*), which would increase to 4% as part of the privileged partnership agreement established between PT, *Caixa Geral de Depósitos* (CGD) and BES.¹¹⁵ Both banks maintained relevant positions in the communications company and become preferred business partners.

The partnership agreement was the initial piece of a major strategy put in place by the Espírito Santo Group to use PT's financial and political power to its benefit. Its influence was reinforced and exerted informally, by filling high profile positions with executives that had worked for the Group in the past; and formally, although in secrecy, by increasing its position in PT, evading the 10% limit on voting rights by using front companies. As an example, Telexpress was constituted in the Cayman Islands in 2001 with the sole purpose of acquiring a position worth €137M, financed by the Espírito Santo Group. Its shareholders were a trust owned by the group in the British Virgin Islands (Ganlet Holdings) and a front company held by Patrick Monteiro de Barros (Intertel Investments)¹¹⁶ (*Ministério Público*, p. 856). In 2006, Telexpress was replaced by two other front shareholders: *Fundação Berardo* acquired a participation of 3,58% fully financed by BES, collateralised by the same stocks. BES also guaranteed a loan of 216 million, granted by Credit Suisse to Ongoing SGPS, with the purpose of buying 22,6 million stocks of Portugal Telecom (p.913).

During the 2000s, PT was a source of value extraction for its shareholders, particularly the Espírito Santo Group, in three ways: preferential servicing contracts, distribution of

¹¹⁴ Henceforth, PT refers to PT SGPS.

¹¹⁵ 'Acordo de Parceria Estratégica no âmbito da Nova Economia: cobrindo as áreas das novas tecnologias, comunicações, conteúdos e comércio electrónico'.

¹¹⁶ Shareholder, together with the Espírito Santo Group, of Petrocontrol in the privatisation of GALP.

dividends and stock buybacks, and the use of large liquidity pools to finance short-term debt.

BESI, the investment bank associated to BES, was involved in all Portugal Telecom's major financial operations. Between 2001 and 2008, its services were valued in €24M. If other companies are included, the Espírito Santo Group received, only between 2006 and 2008, €81M in servicing contracts (€224M if the period between 2006 and 2014 is considered) (pp.860-861).

From 2001 onwards, the PT Group started to invest relevant shares of its free cash flow in short-term debt securities issued by the Espírito Santo control holdings (ESI and Rioforte). In 2004, an internal instruction was issued to centralise the management of PT SGPS cash pools under the direct order of the CFO and CEO. In that same year, PT invested €1.218M in Espírito Santo debt. As showed in Table Ap. 12 in the Appendix, between 2001 and 2010, PT SGPS invested on average 60% of its liquidity on short-term securities, constantly rolled over to meet the Espírito Santo Group long-term financing needs. According to an external audit, in 2013 PT issued 200 million in commercial paper and 1000 in medium-term notes in order to invest, at a cost, in ESI. The audit concludes that 'PwC cannot exclude the possibility that ESI/Rioforte may have defaulted before July 2014 if the capital of the financial investments had not been subject to "successive rollovers" (p.24).¹¹⁷

PT's generous dividend policy will be discussed below. However, it is worth noting that the Espírito Santo Group received, between 2000 and 2010, €424M from PT's profits, apart from the balance sheet effects of the frequent stock buyback operations.

Throughout the 2000s, PT's debt continued to increase relatively to its assets, although at a slower pace comparing to the *dotcom* years. Between 2000 and 2009, the net debt grew 50%, while the solvency ratio decreased from 0,3 to 0,1. Indebtedness was mainly justified with the shareholder remuneration policy, and the need to finance foreign activities, mainly the operation in Brazil.

In 2002, PT SGPS and *Telefónica* established a joint-venture to merge all Brazilian holdings into Vivo, the largest operator in the country.¹¹⁸ In 2009, 41%, of PT SGPS' EBITDA was generated by foreign operations, and 38% by Vivo alone.

¹¹⁷ PwC – Resultados da Análise da PriceWaterhouseCoopers, 2015.

¹¹⁸ Telesp Celular Participações (50%), Intertelecom Lda (100%), PTelecom Brasil Sa (100%), Portelecom Fixa SA (100%), Portelecom Participações (30,2%), (Celular CRT Participações S.A. (2,08%).

PT's net results, as well as its cash flows, reflect a highly profitable and liquid company, despite its indebtedness (see Table Ap.11 in the Appendix). Considering its negative financial results, gains were being generated in telecommunications operations, both in Portugal and Brazil, where PT SGPS kept monopolistic or oligopolistic positions. In Portugal, PT held the public concession for landline services for 25 years, since 1995.¹¹⁹ This contract was transferred to *PT Comunicações* in 2000 and, as part of the liberalisation process, the basic network infrastructure was sold to the same company for €365M (the price was determined by the sum of future payments discounted by the cost of public service obligations). During this process, PT SGPS became the sole owner and wholesale provider of services associated to both network infrastructures – cable and PSTN. The Group had 80% of the landline service market share, 50% of the mobile one and 80% of cable services and was condemned for collusive practises and abuse of dominant position in five different processes.¹²⁰

In 2006, PT SGPS was targeted in a hostile takeover bid by Sonaecom SGPS, the Sonaecom Group communications holding. The latter intended to brake the horizontal and vertical monopoly in the sector by merging its mobile company – OPTIMUS – with PT's – TMN – and sell the operation in Brazil (Vivo), as well as one of the domestic landline networks. The acquisition operation was fiercely opposed by the current management, acting on behalf of the most influential shareholder – the Espírito Santo Group. Telefonica, the other reference shareholder, supported Sonaecom, aiming to buy PT's share in Vivo. To resist, the Espírito Santo Group funded front investors (Ongoing and *Fundação Berardo*), and influenced the government, since it controlled *Caixa Geral de Depósitos* and the *golden share*.¹²¹ The defence strategy included a very aggressive shareholder remuneration scheme: spinoff and distribution of *PT Multimédia* shares (€2000M), a share buyback program corresponding to 15,6% of total equity (€2000M) and dividends worth €2100M. The takeover was defeated by 51,5% of the votes and the need to fulfil this scheme justified the additional €1800M in net debt between 2006 and 2008, as well as the increase in the gearing ratio, from 54,7% to 82,4% as net assets were reduced in the proportion of *PT Multimédia*.

¹¹⁹ Decree-law 40/95, 15th February.

¹²⁰ Competition Authority: PRC/2003/02, PRC/2004/01, PRC 2003/05, PRC/2003/02, PRC/2001/14.

¹²¹ The then prime-minister, the CEO and Chairman of PT SGPS, as well as the CEO of BES are being prosecuted for corruption (*Ministério Público*, NUIPC 122/13.8 TELS.B).

In 2010, the financing needs of the Espírito Santo Group, struggling to rollover short-term debt at the control holdings level, led to the sale of Vivo to Telefonica for €7.500M, with a capital gain of €5.423M. In 2011 PT SGPS distributed dividends worth €1.379M. Moreover, as shown in Table Ap. 12 in the Appendix, the proceeds of the selling operation were immediately invested in the Espírito Santo Group in the form of deposits and securities.

In that same year, PT SGPS presented a new joint venture with the Brazilian company Oi, which evolved into a merger in 2013, with the integration of PT's assets worth €1.200M in Oi, corresponding to a participation of 39,7% to be transformed in a share of 37,3% in the new merged holding (CorpCo). In 2014, the Espírito Santo Group filed for bankruptcy and defaulted on the €900M debt titles held by PT SGPS. As a consequence, its share in Oi was reduced to 25,6%. In 2015, Oi sold PT's assets in Portugal to Altice, a French company, and PT SGPS was rebranded Pharol SGPS. Its main assets were, in 2016, a share in Oi and debt securities issued by the Espírito Santo holdings. Portugal Telecom ceased to exist.

Cimpor – 'lost in construction'

The privatisation of the three cement sector companies (the holding Cimpor, Secil – *Companhia Geral de Cal e Cimento S.A.* — and CMP – *Cimentos Maceira e Pataias, S.A.*) started in 1994. Secil and CMP merged under the control of Semapa, owned by the Queiroz Pereira family, which was already competing with Champalimaud in that sector before 1974.

By the time of its privatisation first stage (20% dispersed in the stock market) Cimpor's market share in the cements sector was 85%.¹²² The company had already started its internationalisation process, with the acquisition of *Corporacion Noroeste* (Spain) in 1992 and 50% of *Cimentos de Moçambique S.A.* in 1994. The second stage of privatisation occurred in 1996, with an additional share of 45% being sold. On total, the company had by then 80.000 shareholders, without any individual participation above 20%. In that same year, Cimpor acquired 55% of *Asment de Témara* (Morocco) and, in

¹²² In 1992 Cimpor held 85% of the total market share while Secil had 25%. Secil was privatised in 1994 to Semapa, a holding company controlled by Pedro Queiroz Pereira created in 1991 to bid for cement companies in privatisation processes. To equilibrate the market share, the government determined the acquisition, by Secil, of two of Cimpor factories, aggregated under C.M.P. - *Cimentos Maceira e Pataias* before the privatisation (in *O fim da Cimpor*, by Luis Todo Bom in *Jornal de Negócios*, 1st of July 2012).

the following year, entered the Brazilian market with the creation of *Sociedade de Cimentos do Brasil* (from Cisafra and the cement business of Serrana's Group). In 1998, after the privatisation of another 25%, the State kept a share of 10% in Cimpor, which then had 500.000 shareholders. The internationalisation strategy was reinforced with new acquisitions in Tunisia (*Société des Cimentes de Jbel Oust*), Brazil (Brennand Group)¹²³ and Egypt (Amreyah Cement Company). In 2002, Cimpor operated in eight countries, occupied the tenth position in the world ranking and dominated the Portuguese and Mozambican cement markets. In 2005, it acquired important companies in Cape Verde (*Cimentos de Cabo Verde*), in 2006 in Turkey (Yitibas Lafarge) and China (*Shandong Liuyuan*), in 2007 in Peru (*Cementos Otorongo*) and India (Shree Digvijay). The priority given to foreign markets is reflected in the progressive loss of the Portuguese share in the company's total EBITDA and turnover (Table Ap. 13 in the Appendix).

Cimpor was considered the most important Portuguese multinational¹²⁴ and its strategic importance to the Portuguese economy, and in the context of the world cement sector, was reflected in its shareholder structure in 1999, composed by the two world market leaders – Holderbank (10%) and Lafarge (9,5%); international companies - *Cementos Mollins* (2.6%) and Fernhill Holdings (9.5%); national competitors — Secil (9%); the banking sector — BCP Group (11%); the construction company Teixeira Duarte (12,5%) and the Portuguese State (10%).

From 2002 onwards, the main holding, Cimpor SGPS, located in Portugal, aggregated three main sub holdings: Cimpor Portugal SGPS (activities in Portugal), *Cimpor Inversiones S.L.* located in Spain (foreign activities) and *Cimpor Investimentos SGPS* (non-core activities). Financing operations were mostly concentrated in two foreign companies, participated by the main holding: Cimpor Financial Operations BV (Netherlands) and Cimpor Finance Limited (Ireland). The use of holding companies located in territories with favourable taxation regimes was widespread among large companies.

Its operational cash-flow (EBITDA) increased by 595% between 1994 and 2000. However, as with other large monopolistic groups, overseas expansion in the late 1990s was supported by higher indebtedness: net debt increased by 706%, 3.2 times the growth in its assets and 6.9 times its equity. During the 2000s Cimpor's financial situation

¹²³ *Companhia de Cimentos Goiás, Companhia de Cimento Atol and Companhia de Cimento Portland.*

¹²⁴ Prize of *Exame Magazine* for the Best Company of the Decade in 1999.

stabilised. Despite some increase in the debt-to-EBITDA ratio between 2000 and 2010, the additional (net) debt was much smaller than in the five previous years and about half the relative increase in net assets.

In spite of elevated payout ratios (average of 57% between 1994 and 2010), Cimpor's attractiveness was not based on its pure remuneration capacity, but on stock price inflation. The total stock cumulative gains between 1995 and 2010 reached 2488%, also reflecting the instability of its shareholder structure because of controlling aspirations of both international groups – looking to acquire its international market share – and national shareholders – willing to use Cimpor' strategic position to gain advantage in national power disputes.¹²⁵

In the following 15 years, Cimpor was targeted by three takeover attempts.

The first was in 2000, by its competitor Secil, through Secilpar, in concert with Swiss Holderbank Financière Glaris. The purpose was to share the company's assets between both groups, but the deal did not obtain the necessary authorisation from the Finance Minister, who invoked the defence of the group's integrity and national shareholder control. The priority given to national shareholders might explain why the government selected the national construction group Teixeira Duarte as buyer of the last 10% of Cimpor. The deal was worth €410M, financed by *Caixa Geral de Depósitos* and BCP (in which Teixeira Duarte had a participation of 2,45%). It was a competitive process, however, and the remaining shareholders, mostly Queiroz Pereira, contested the dismissal of a formal authorisation process for shareholdings above 10% (31,35% in this case). The decision revealed the power and influence of BCP as had happened, in other circumstances, with BES.

In 2004, two other BCP shareholders, *Fundação Berardo* and Manuel Fino, both financed by BCP and *Caixa Geral de Depósitos*, acquired participations in Cimpor. Two years later, Manuel Fino aggregated both shareholdings. The banking group was determined to dominate the industrial conglomerate, until an internal conflict contaminated Cimpor's shareholder alliances. Manuel Fino — who supported one side of the conflict in BCP — acquired a participation in Soares da Costa SGPS, the direct competitor of Teixeira Duarte in the construction sector, and on the opposite side in BCP's conflict. Both groups fought to control Cimpor. The indebtedness levels of both groups, allied to BCP losses in stock

¹²⁵ In 2001 Cimpor was considered, by the Financial Times and the London Stock, the European company with the best shareholder return (European Top Companies 2001 / Best performing company over 1 year.)

prices during the internal war and the international crisis, jeopardised Cimpor's stability and created the conditions for future takeover attempts by Brazilian shareholder groups. Hence, in 2009 *Caixa Geral de Depósitos* received, in lieu of payment for Manuel Fino's debt, 10% of Cimpor. The remaining Portuguese shareholders were also pressured by debt levels and in need of liquidity. Still, the first takeover bid, by CSN - *Companhia Siderúrgica Nacional* (Brazil) was rejected in 2010, with the crucial contribution of *Caixa Geral de Depósitos*. Meanwhile, Camargo Corrêa — a Brazilian construction group with great political influence in Portugal and Brazil — had acquired Teixeira Duarte and Bipadosa participations in Cimpor. At the same time, Votorantim, the direct competitor of CSN in the Brazilian cement market, agreed on an asset swap to acquire Lafarge's position in Cimpor. After these operations, Camargo Corrêa was in position to announce a new takeover bid with the support of Votorantim. The price (€5,5 per stock) was below the previous offer by CSN (€6,46), but the government had changed and a new privatisation wave under the Troika¹²⁶ determined the State-owned bank's decision to sell.

After the acquisition, a demerger operation was put in place. Cimpor was integrated in InterCement, controlled by Camargo Corrêa; and its assets in Spain, Morocco, Turkey, Tunisia, China, India and Peru were swapped with Votorantim in exchange for 21% of Cimpor's share capital. In the merger between Cimpor and Intercement, the latter transferred assets worth €1.200M with an associated debt of €2.034M to the former. In 2016, Cimpor's debt levels and registered impairments associated to the Brazilian operation led to losses of €788M and, in 2017, the company was delisted from the Lisbon Stock Exchange, at a price of €0,34 per share.

Electricidade de Portugal – profits from rents

The State-owned enterprise EDP – *Electricidade de Portugal, S.A.* was created in 1976 to 'establish and explore the public service of production, transport and distribution of electric energy in the continental territory' (Decree-Law 502/76, 30th of June). In 1997 its privatisation started as part of the reorganisation of the energy sector under European

¹²⁶ Troika refers to the three institutions – IMF, European Commission and ECB – that coordinated the austerity programme in Portugal between 2011 and 2014.

Union directives: separation between transport, production/distribution and sales, privatisation and liberalisation of the Iberian market (Mibel).

In 1988, the sector opened to private initiative and, in 1991 it was restructured to eliminate the vertical integration in electricity production, concentrated in EDP¹²⁷. Assets connected to distribution were transferred to REN (*Rede Eléctrica Nacional*), which held the concession of the national electricity transmission network. REN was integrated in EDP until 2000, when 70% of it was transferred to the State, and its privatisation started in 2007.

After dispersing 29,9% of EDP's capital to more than 700.000 shareholders, this privatisation was presented as the ultimate expression of so-called 'popular capitalism'.¹²⁸ The term was introduced as an ideological justification for the large privatisation programme, meaning the transition from a State monopolised economy to a democratic capitalistic system.

In 1998, the government decided to open the shareholder structure to foreign investors. As in the case of Galp, Pina Moura, the relevant minister, opted for a direct sale to Iberdrola, the second largest Spanish electrical company.¹²⁹ Both companies crossed shareholdings of 2,75% during EDP's third privatisation stage, when additional 16,2% were sold. Iberdrola raised its participation up to 9%, despite the suspension of the agreement motivated by divergences regarding the statutory limit to voting rights for participations above 5%. After 2001, Iberdrola intended to circumvent these restrictions by managing the company in partnership with BCP.

Since the late 1990s, EDP assumed two strategic investment and growth areas: internationalisation and telecommunications. After the disappointing performance of the latter, the focus was turned to the renewable energy sector.

Its noteworthy that, in 2000, EDP controlled 82% of the electricity production capacity in Portugal and was its sole distributor until 2009. The consolidation of the internal market, obtained by regulatory and historical reasons, opened room for larger investments abroad.

¹²⁷ Decree-Law 449/88, 10th December, Decree-Law 7/91, 8th January, Decree-Law 131/94, 19th May, Decree-Law 182/95, 27th June.

¹²⁸ 99.788.000 shares through an IPO to small investors and workers and 80.172.000 shares in a direct sale to institutional investors. It was also admitted for negotiation at the NYSE.

¹²⁹ In 2004, Pina Moura was appointed CEO of Iberdrola.

Between 1998 and 2000, EDP invested €1.414M in foreign activities, mostly in Brazil and Spain, but also in Guatemala, Cabo Verde, Macau, Morocco and Chile. In 2001 this investment strategy continued: 45% of the total financial investment (€588M) was directed to the operation in Brazil, namely through the acquisition of Escelsa; and the remaining to finance part of the takeover bid over Hidrocantábrico, the fourth largest electric company in Spain. In 2002, both investments absorbed €380M and €783M, respectively, 85% of the total financial investment (the remaining corresponds to €168M invested in BCP). This aggressive acquisition strategy was financed with debt. EDP's financing structure was, on average, constituted in 75% by medium and long-term debt, more than 50% in the form of bonds. As with other large companies, EDP Finance BV, in the Netherlands, centralised an important share of financing operations.

In 2004 EDP acquired an additional stake of 56,2% in Hidrocantábrico (to 95,7%) for €1.200M, financed through a capital raise, partially subscribed by CajAstur: 'The increased control over HidroCantábrico was one of the most notable and relevant events in EDP's history. It was recorded as one of the largest financial transactions of the year at European level, the largest capital increase in Portugal and the largest investment in Spain by a Portuguese company.' (Annual Report, 2004, p. 105) As a consequence of these important acquisitions, EDP consolidated debt increased by 36%.

Investment in communications, in turn, absorbed €810M between 1998 and 2000, and it was mainly focused in the creation of a new telecommunications operator, ONI, and the control of Optimus (with Sonae), a mobile operator, both under the sub-holding OPTEP. These investments, as well as other projects in e-finance, took place in the context of a larger partnership with Galp, Brisa and, in particular, BCP, who acquired 5.058% of EDP's capital, in exchange for a share of 4% held by the electrical company in the bank, worth €502M (Annual Accounts, 2000). Both institutions had the right to appoint crossed board members.

EDP's incursion in the communications sector, as well as its partnership with BCP, resulted from the direct intervention of the Prime Minister, António Guterres.¹³⁰ The government had concerns regarding the (almost) monopolistic position of Portugal Telecom, together with BES, and supported the creation of an alternative group in the

¹³⁰ Osório (2014) and Martins & Machado (2015).

sector. It was also in 1999 that EDP acquired a qualified participation of 11% in GALP SGPS from Petrocontrol, to enter the gas sector.

In the second half of the 2000s, the investment strategy turned from telecommunications to renewable energy (hydraulic and wind). EDP sold ONI and traded Optimus for a participation in Sonaecom (15,91%), which was sold in the following years.

There were two important landmarks in this period. The first was the acquisition of Horizon Wind Energy, in the USA, to Goldman Sachs, for €2.740M, wholly financed by new debt issues, which made EDP the fourth world wind energy producer. The second was the approval, by the Portuguese government, of the National Programme of Dams with Significant Hydroelectric Potential, which included the construction and concession of seven new dams, increasing the installed capacity from 5900 MW to 7000 MW. The plan was heavily contested, mostly by environmentalist organisations that questioned the benefits of new generation power (additional 1,7% of electric production capacity) in face of the environmental and financial costs (estimated in €10.000M, including a €21,6M ten-year's annual subsidy per project). Three of the projects were adjudicated to EDP, although only one went through. Additionally, the government decided to extend existing concession contracts (and corresponding subsidies) of 27 hydropower plants with EDP for 25 years, ignoring an opinion issued by the Portuguese Water Institute claiming for a public tender.

These two operations reflect the structure of EDP's activity and profitability towards the end of the decade. On the one side, wind energy, mostly located overseas – Italy, USA, Canada, UK, China, Brazil, France, Belgium, Poland and Romania – were aggregated under EDP Renováveis. In 2008, EDP sold 25% of it in an IPO, and bought it back at discount ten years later. On the other side, national activity remained under monopolistic conditions and highly protected by the state: '75% of the group's investment is related to regulated businesses and long-term contracted generation, which benefit from a low risk of return on investment' (Annual Accounts, 2007).

The investment bias towards foreign activities is clearly shown in the share of fixed assets associated to the activity in Portugal, that went from 77% in 2003 to 20,8% in 2010 (see Table Ap. 14 in the Appendix). The same downward trend can be found in terms of the company's turnover. However, due to the protection enjoyed in the domestic market, the operation in Portugal was responsible for a much larger share of the net income (123% in 2003 and 65,7% in 2010).

The protective regime enjoyed by EDP was originally designed to inflate its value during the privatisation, so to artificially ensure that the energy sector was attractive to private initiative. After liberalisation, in 1988 and 1991, the State celebrated several Power Purchase Agreements (EPP), establishing the mandatory acquisition, by REN, of all the energy produced in the Public Service Electric System, at a regulated price. Final consumers were to be charged with the difference between wholesale price and the real cost determined by the EPP: ‘The long duration and the absence of commercial risk to the seller are the main characteristics of the CAE [PPA] model, which benefited EDP from 1996 on, after the end of the legal monopoly regime. With the signing of the new CAE, all risks of competitive nature that could result from the liberalisation process have been borne by consumers.’ (AdC, 2013, p.9)

The creation of the Iberian Energy Market introduced higher requirements to guarantee the ‘free competition’ in the energy sector and determined the early termination of PPAs.¹³¹ In substitution, compensatory measures were established, named Costs for the Maintenance of Contractual Equilibrium (CMEC), valid between 2007 and 2017. The new system was devised to preserve the net present value established in the PPAs, granting assets an 8,5% rate of return, supported by consumers. The structure of compensation included one fixed component and one variable, named ‘revisable mechanism’, composed by four variables, two of them controlled by the producers.

Therefore, CMECs were designed to create an incentive for EDP to shape its production plans in order to maximise the compensation, namely by shifting and optimising production to plants operating on a market basis and keeping CMEC plants operating under capacity. The fact that EDP does not have an explicit incentive to maximise revenue from CMEC power plants could result in a less efficient behaviour from an economic point of view, leading, *ceteris paribus*, to compensations borne by consumers that are higher than those that could be paid on the basis of optimising behaviours.’ (p.5)

Overall, such compensations were responsible for a share of these plants’ revenue which varied between 17,7% (in 2007) and 43,7% (in 2009), corresponding to a share between 16,3 and 34,2% of EDP’s pre-tax income. The same distortion occurs under the Special Regime Generation, applicable to the renewables sector, where production is subsidised depending on the technology used, generating an extra cost, on average, 50% above the

¹³¹ Decree-Law 185/2003, 20th August and Decree-Law 240/2004, 27th December.

market price.¹³² As the weight of renewable energy increased, the associated cost varied from €157M in 2007 to €805M in 2010 (EDP owned 25% of all wind production capacity).

EDP's dimension and profitability made it an attractive company, both to shareholders in search for short-term remuneration – national banks and international funds — and foreign competitors. Between 1997 and 2010, EDP distributed €5.786M in dividends, more than Portugal Telecom (Table Ap. 14 in the Appendix). In 2011, the company went through its last privatisation stage, with a direct stake of 21,35% being sold to China Three Gorges Corporation, which became the controlling shareholder. The operation was criticised by the Court of Auditors, due to a conflict of interests in the choice of the advisory banks: BESI participated in the evaluation on the government's side while acting as the buyer's financial advisor.

7.4. In the aftermath of privatisations — profitable Public Private Partnerships

After Brisa, constituted in 1972, the first PPP experiences in Portugal were carried out in 1993, namely with *Lusoponte*, encompassing the concession of the *25 de Abril* bridge and the construction and operation of *Vasco da Gama* bridge. In the late 1990s, the decision to expand the highway network from 400 km to 3000 km and to break with Brisa's monopoly opened the door for several new PPP contracts in the road sector. The next main PPP projects were in the healthcare and railway sectors. In the water and sanitation sector, concessions were assigned to municipal companies; in the energy sector, to the operators privatised – EDP and REN –, as well as to other large electric multinationals. Finally, ports' concessions were also allocated to private operators.

Between 1995 and 2010, the Portuguese government launched 35 Public-Private Partnerships, in four structural sectors. On the whole, these projects represented a total investment of €13.929,8M, registered as private debt and private investment.

¹³² Decree-Law 189/88, Decree-Law 339-C/2001, Decree-Law 33-A/2005.

Table 5 - PPP projects 1995-2010

	Number	Average Concession Period (years)	Investment (million€)
Roads	22	30,4	12329,5
Railways	2	20,5	1168,7
Security	1	20,0	112,0
Healthcare	10	20,0	319,2
Total	35	28,1	13929,4

Source: *Parcerias Público-Privadas, Relatório de 2010*, DGTF.

There is no definite definition for the concept of Public-Private Partnership. The European Commission has often referred to these type of contracts as ‘the transfer to the private sector of investment projects that traditionally have been executed or financed by the public sector’ (European Commission, 2003, p.128). Additionally, according to the European Commission, PPPs must meet four requirements: the project ought to involve a public function, the government must be the main purchaser of the service, it must be financed by private debt and be conceived by a private operator that also bears part of the risk. In Portugal, the first legal framework was created in 2003 and it defined PPP as ‘the contract, or the group of contracts, by means of which private entities, designated by private contractors, are permanently obliged to a public partner to ensure the development of an activity tending to the satisfaction of a collective need, and in which the financing, and responsibility for the investment and the exploitation rest, in whole or in part, on the private partner.’ (Art.2)¹³³ Furthermore, in Portugal, there is a distinction between a concession and a PPP. In the former, the private company manages a public asset – usually in water, sanitation, energy, ports and airport sectors – assuming the risks involved; in the later, the private counterpart assumes the building costs, and the State guarantees regular payments during the contract period.

¹³³ Decree-Law 86/2003, 26th April.

The IMF identifies three different groups of PPPs, summarised in Table AP. 15 in the Appendix. In Portugal, most PPPs followed a BOOT structure, in which the private consortium builds and runs the infrastructure for an agreed period of time, without the actual ownership of the underlying asset. The private structure included, in most cases, a consortium of contractors and banks, in the form of a Special Purpose Vehicle (SPV). By forming an SPV, private companies limit their own risk and keep the investment off-balance sheet (for participations under 50%). Additionally, SPVs protect companies' brands in the event of a bankruptcy.

It is clear that the growing importance of PPP contracts in the late 1990s is directly related to the declining importance of privatisations. It was, as admitted by the IMF, a strategy to stimulate private capital markets and to overcome legal and social difficulties in privatising important sectors, like healthcare.

‘By the late 1990s privatisation was losing much of its earlier momentum, yet concerns about infrastructure remained in many countries. It was at this time that PPPs began to emerge significantly as a means of obtaining private sector capital and management expertise for infrastructure investment, both to carry on where privatisation had left off and as an alternative where there had been obstacles to privatisation.’ (IMF, 2004, p.4)

The choice of PPPs as a preferred model for channelling public investment responded to the needs and interests of both public and private agents. First of all, it comprised an ideological strategy to proceed with the dismantling of the social and economic functions of the State, opening new business areas for private companies. This practise was actively encouraged by European institutions. It was a way to bypass the deficit and debt rules inscribed in Article 1 of the Protocol on the Excessive Deficit Procedure, established in the context of the Maastricht Treaty. Governments were encouraged to replace large up-front expenditures for a stream of future payment obligations. In the short-run, these investments were financed by private debt, classified as private capital formation and kept off the public balance sheets. Besides, private indebtedness was eased by providing means of financing, mostly through European Investment Bank loans, to private consortiums. ‘That bank did not only offer loans at a lower interest rate when compared with the market at the time, but also loans with longer maturities. The EIB also provided expertise and rendered international credibility to the PPP programme. It was an important factor in encouraging international banks to participate in PPPs in Portugal.’ (Sarmiento & Renneboog, 2014)

For private contractors and banks, PPPs represented important business opportunities with stable income flows and little competition. Indeed, Project Finance became an important business area for banks, struggling to increase market shares. Unlike other forms of financing, ‘project finance is a method of financing large-scale, capital intensive projects, in which only the cash flows generated by the project serve as the source of loan repayment and project assets serve as collateral for the loan’ (Farrell, 2003). For the private counterparts involved, debt financing was relatively cheaper and safer than equity, since not only could interest payments be deductible for tax purposes, but the shareholder responsibility was also limited to the assets involved. According to Sarmiento and Renneboog (2014), debt represented around 70% of total PPP investment, and 34% of total debt was provided by the EIB. On the other hand, for projects to be sustainable, they must yield sufficient cash flows during their lifetime to cover all operational costs involved, debt repayments and capital returns for private agents.¹³⁴

To minimize credit risk and increase profitability, market risks were often transferred to the public sector. This strategy was particularly visible in railway and highway projects, where the payment method depended, not on real toll revenues, but on public payments triggered by certain demand or supply events.

In the case of Fertagus, operating a central railway service since 1999, a traffic band system protected the private operator from the risk of low traffic, overestimated by 31% in the initial contract. Its renegotiation led to the payment of fixed amounts by the public sector, plus tolls revenues. It was only in 2011 that the PPP became self-financed (*Tribunal de Contas*, 2012, p.13).

Lusoponte was the first PPP, established in 1994 to manage the existing *25 de Abril* and to build and manage the new *Vasco da Gama* bridges. The private consortium included the largest construction companies in the country. The payment method was based on tolls revenues, with no extra cost for the State, except in the case of an event able to trigger a Financial Rebalancing Agreement (FRA). Between 1995 and 2012, nine FRAs were responsible for €846,8M in compensations by the State.

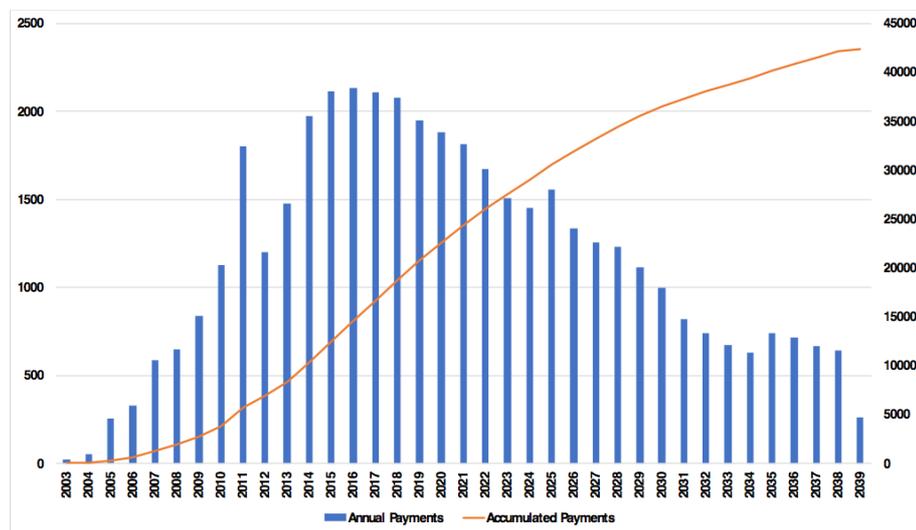
In the highway sector, several types of payment methods have coexisted and changed over the time. In general, there were two waves of PPPs. The first included seven highways, designed as ‘no cost to the user’, using a system of shadow tolls, in which the

¹³⁴ This capacity was measured through the calculation of Debt Service Cover Ratios, the relation between interest and amortization payments and the free cash flow.

State paid the private operator according to traffic. The initial overestimation of the expected demand led to additional public payments to compensate for investment costs. In 2010 the contracts were renegotiated, and demand payments were substituted for fixed amounts, based on the same overestimated models. According to the Portuguese Court of Auditors, the renegotiation was determined to meet shareholders' returns expectations, increasing costs to the public counterpart: 'The State agreed to assume the losses of concessions under the real toll system (in particular the North Concession) that were the responsibility of concessionaires (also due to the imposition of the financiers)' (*Tribunal de Contas*, 2012, p.20). During this renegotiation, the payment method for some second-generation highway PPPs (*Norte and Grande Lisboa*) was also changed from real tolls to the availability method, again increasing public payments.

It was only in 2008 that the first official report on PPPs was published. Before that, there is no aggregate information on future costs associated to these projects. Using data from the Ministry of Finance, Sarmiento and Renneboog (2014) provide an account of total past and future payments, in euros, at current prices, as well as the net present value (NPV) of future public payments associated to each project.¹³⁵

Figure 21 – PPP payments, 2003-2039



Source: Sarmiento & Renneboog (2014). PPP payments. €Million, current prices.

Overall, between 2003 and 2049, the 35 identified PPP contracts have associated payments worth €42.373M. It should be noted that due to the instability associated to

¹³⁵ The authors use a discount rate of 6%, commonly found in official analyses of investment projects.

contracted payments flows, future financial obligations are difficult to predict. Before 2015, the base year for the calculation of NPV in Table 16, the State had already paid € 12.420M, almost the equivalent to the total investment associated to these PPPs (€13.929M). After 2015, future payments, net of predictable cash inflows, discounted at a rate of 6%, will add up to €14.913M.

It is clear, not only from the amounts involved, but also from the discrepancy between the value of the investment and the financial flows associated, that the State, through PPPs, supported the activity and profits of private conglomerates, composed mainly of banks and construction companies. Table Ap. 16 in the Appendix condenses the information available on PPP contracts, their shareholders and investment values. The main beneficiaries of these investment options were, in the construction and concession sectors: Brisa (six contracts), belonging to Vasco de Mello Group, Espírito Santo Group (ten contracts), Mota Engil Group (nine contracts), Somague Group (seven contracts) Teixeira Duarte Group (five contracts), MSF (five contracts)¹³⁶, apart from other relevant international companies. As for banks, both BES and BCP had a relevant shareholder role in these projects, but all large national and several international banks were involved as financial partners in PPP projects. In the health sector, Espírito Santo Group and José de Mello Group shared the concessions of the four PPP hospitals.

7.5. Banking Sector: concentration and expansion

7.5.1. Competition through concentration

In the 1990s, the Portuguese banking system went through a process of expansion and transformation, as privatisations and market liberalisation proceeded under the guidance of the European Economic Community, aiming at the establishment of a single market for financial services.

The new legislation reflected the European Directives dictating the free movement of capital, the European Passport for foreign banking institutions, and common basic prudential and regulatory standards.¹³⁷ The sector was opened to private initiative in 1984

¹³⁶ MSF – Moniz da Maia, Serra & Fortunato, results from the split, in 1969, of the construction company Moniz da Maia e Vaz Guedes S.A.R.L.

¹³⁷ Directive 88/361/CEE establishing free movement of capital; Directive 89/646/CEE of European Banking Coordination establishing the European Passport and regulatory standards such as the universal banking model; Directive 89/99/CEE establishing common basic standards for the own funds of credit institutions; Directives 89/647/CEE and 89/299/CEE, establishing minimum solvency ratios of 8% of own funds; Directive 92/30/CEE, concerning the supervision of credit institutions on a consolidated basis;

and privatisations began in 1989. Meanwhile, four regulatory decisions were particularly relevant to change the context of a State-owned banking system, operating under administered interest rates and credit ceilings.

First, credit ceilings were replaced by indirect monetary instruments in 1991. In previous years, these limits had been used to the advantage of newly created private banks, in detriment of State-owned institutions. This decision was followed by the completion of interest rates' liberalisation in 1992.

In second place, the notion of universal banking was introduced in 1992. Banks were now allowed to offer new services (factoring or leasing), and the opening of new branches was liberalised.¹³⁸ The prevalence of universal banks in the Portuguese system created a pressure for large intermediation margins based on the competition for larger shares of the retail market.

Thirdly, the minimum cash reserve requirements ratio dropped from 17% to 2% in November 1994, allowing the expansion of balance sheets.¹³⁹ Fourthly, the new legal framework applied to the Portuguese Central Bank explicitly banned the monetisation of government debt,¹⁴⁰ leading to the creation of new public debt instruments, a new business area for the banking system.

The rapid liberalisation process brought about an increase in the number of institutions operating in the country — from 35 in 1992 to 56 in 1995 — and an intense competitive struggle based on price and scale. Marketing strategies and geographic expansion were important features in the growth of retail banks (BdP, 1994, p. 159) and contributed to increase the supply of banking services relative to demand, given the low indebtedness levels. The share of loans in total assets decreased between 1992 and 1996, from 41,8% to 34,1%, while competition through intermediation margins, combined with falling inflation, pressured returns downwards: average ROA from 1% to 0,6%, ROE from 12,8% to 8,2%, and financial margin between 4,6% to 2,9% between 1991 and 1994.

In the second half of the decade, the financial margin continued to decline (due to the decrease in nominal interest rates) to values closer, although still above, the European and euro area average (BdP, 2000). This was partially compensated with higher credit

Directive 91/308/CEE, on prevention of the use of the financial system for the purpose of money laundering; and Directive 92/121/CEE on the monitoring and control of large exposures of credit institutions. These Directives were transposed into the Decree-law 298/92, 31st December – *Regime Geral das Instituições de Crédito e Sociedades Financeiras*.

¹³⁸ Decree-law 298/92, 31st December.

¹³⁹ Aviso 7/94, 24th October.

¹⁴⁰ *Lei Orgânica do Banco de Portugal*, Decree-law 337/90, 30th October changed by the Decree-law 231/95, 12th September.

levels, mostly between 1996 and 2000, when total loans, as percentage of average total assets, increased from 34,1% to 63,2%. This relative increase took place in the context of expanding balance sheets in the banking sector.

The composition of these expanding loans portfolios was largely determined by the regulatory framework, based on the First Basel Accord, established in 1988, and also laid down in the European Directives. The new system classified assets into five risk categories and established minimum Tier 1 and 2 capital requirements equal to 8% of risk-weighted assets:

- Cash, central bank and government debt and OECD government debt: 0%
- Public Sector debt: 0%, 10%, 20% or 50%;
- Development bank debt, OECD bank debt, OECD securities firm debt, non-OECD bank debt, and non-OECD public sector debt, cash in collection - 20%;
- Residential mortgages - 50%;
- Private sector debt, non-OECD bank debt, real estate, plants and equipment, capital instruments issued at other banks - 100%;

Based on these capital rules, banks had strong incentives to favour loans backed by housing collateral (construction and real estate activities) or by State guarantees (municipalities, PPP projects). There was also a more general bias towards non-tradable activities, including utilities, retail activities, where profit mark-ups were twice those found in the tradable sector (IMF, 2013, p.57).

In the last years of the 1990s and beginning of the 2000s, two related tendencies emerged as part of the expansion strategy of national banks, determined by the need to find alternative sources of profit to net interest margins. The first is project finance, related to PPPs:

‘The use of credit by the Portuguese business groups for the financing of restructuring operations and the promotion of the concession for the construction and operation of public road infrastructures ... should have contributed, in part, to the high levels of growth of bank credit to non-financial corporations in recent years.’ (BdP, 2000, p.220)

The second is financial operations. Initially related to privatisations, trading and direct holding of participations in privatised companies, it changed, as investment slowed down during the decade, to merger and acquisition operations:

‘In turn, as corporate investment continues to show a modest evolution, the main motivations for maintaining high gross financing flows are associated with financial operations, such as mergers and acquisitions and debt restructurings’ (BdP, 2006, p.13)

During this period, and contrary to the objectives of liberalisation, the sector became more concentrated. The number of banks and foreign branches increased between 1992 and 1999/2000 (from 36 to 62) but the largest banks engaged in large M&A operations as a response to excessive supply and to reinforce barriers to entry.

Between 1999 and 2000, growth strategies of recently privatised banks determined the largest registered number of mergers and acquisitions in the sector. CGD merged with BNU in 2002. BCP had already acquired BPA in 1995, the second largest bank in 1994. In 2000 it merged with *Banco Mello* and BPSM, the fifth and fourth largest banks in the country, respectively. In 2005 BES absorbed *Banco Internacional de Crédito* through a merger by incorporation. Santander had acquired BTA and *Crédito Predial Português* in 1999.

In terms of assets, the concentration ratio for the five largest banks increased from 55% in 1991 to 83% in 2000, floating around that value until the financial crisis of 2008. The same pattern applies to the market shares of total loans, deposits and net income (Table 7).

Table 6 - Market Shares of the five largest banks (C5)

C5	1991	1995	2000	2005	2010
Loans	55,4	76	83,3	83,6	84,9
Deposits	59,7	80,6	85,1	85,6	80,0
Assets	55,2	77,6	83,4	82,9	75,9
Net Income	66,3	90,3	87,38	98,4	117,3

Source: Portuguese Banks Association and *Banco de Portugal*. Notes: Until 1994 loans refer to internal loans. Values until 2000 are given in the *Banco de Portugal* reports. After that the calculation uses *Banco de Portugal* consolidated balance sheet data and individual data from APB.

However, the objectives of banking capital concentration went beyond pure commercial reasons. What was at stake was the power to – through the banking system – influence and, to a great extent, determine the specific organisation of capital in the country.

The crucial influence mobilised by banking capital was clearly exposed in the high-profile cases of Portugal Telecom — in the takeover bid by Sonae – and Cimpor – through the controlling efforts of BCP — but was structural in the context of the Portuguese bank-based system. Besides the abstract forms of political and social power, banks: i) financed important shares of the largest companies' balance-sheets, through loans and by holding large pools of debt securities, ii) financed the acquisition of stocks by other shareholders, with or without custody¹⁴¹; and iii) acquired strategic participations in non-financial companies:

‘Contrary to the dominant practice of the 1980s and 1990s, and the guidelines adopted in the 1992 White Paper for the Financial System, main Portuguese banks embarked on a strategy of taking relevant positions in the capital of non-financial corporations and other banks. Such behaviour was based on several convergent motivations: support the control of these companies by national shareholders; the desire to secure a relevant portion of the banking business associated to these companies; and, in some cases, the intersection of shareholding within the banking system’ (Alves & Tavares, 2017, p.73).

These practices deserve attention as they are indicative of the circular nature of the Portuguese shareholder capital structure. Either through direct or indirect forms of control, this circularity constituted, at the same time, a systemic fragility and a form of concentration and accumulation of power in a small number of strategic shareholders.

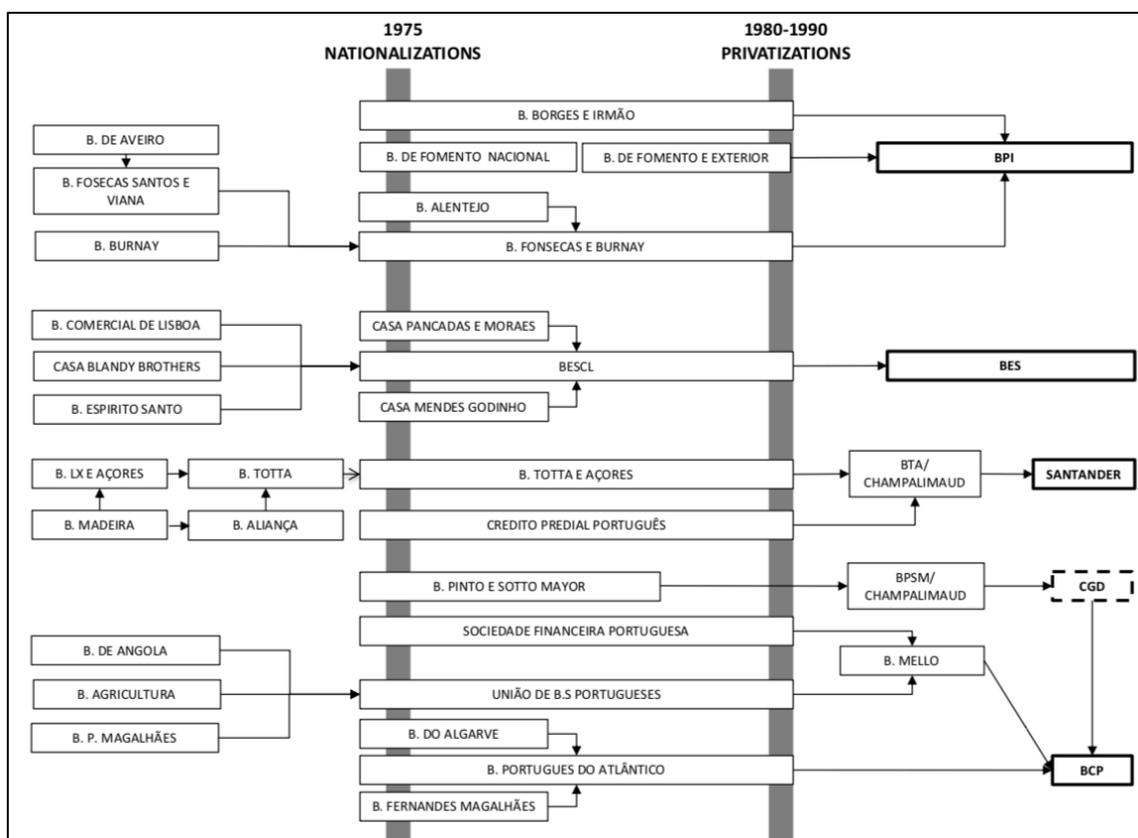
7.5.2. Banking Groups

During the 1990s and 2000s, four private banks consolidated their positions through a combination of endogenous growth and mergers and acquisitions. Two of them – BPI and BCP – were founded after the banking liberalisation in 1980, and the other two – BES and Banco Totta – were nationalised and then privatised and sold to their previous owners – Champalimaud and the Espírito Santo family.

¹⁴¹ According to the statistics provided directly by CMVM, the total value of loans granted for the purchase of securities was €22,3B between November 2000 and November 2008.

The following scheme shows the concentration process that allowed the consolidation of these four private banks, described next:

Figure 22 - Evolution of the banking system



Source: Figure adapted with permission from Tabela 6.1 in Costa et al. (2010), using information from Faria & Mendes (2013).

BPI – Banco Português de Investimentos

Banco Português de Investimentos (BPI) came from *Sociedade Portuguesa de Investimentos*, the first private financial institution created in 1981 by a group of 100 Portuguese businessmen together with international banks. *Banco Português de Investimentos* grew rapidly in its first years of activity, mostly due to its role in privatisation operations (Faria & Mendes, 2013, p. 352). In 1991 BPI absorbed *Banco Fonecas e Burnay* in the privatisation process, and, in 1994, it acquired an insurance company – *A Social* – and 26% of *Portugal Previdente*.¹⁴² The acquisition strategy proceeded in 1995 with *Banco de Fomento Exterior*, which was, in turn, owner of *Banco*

¹⁴² 80% of *A Social* were already owned by *Banco Fonecas & Burnay*.

Borges & Irmão. In 1998. Retail banks merged into *BPI Banco Comercial*, whilst investment activity remained in *BPI Investimento*. In 1998, the group was restructured under BPI SGPS, and BPI became a universal bank.

BCP – Banco Comercial Português

Banco Comercial Português (BCP) was also product of the banking system liberalisation in the 1980s. It first emerged by initiative of a group of 205 investors, led by the Amorim family, with 20%.¹⁴³ In 1993, that participation was sold to *Banco Central Hispano* (Costa et al., 2010 and Amaral, 2015) in the aftermath of disagreements with the bank's CEO, Jardim Gonçalves.¹⁴⁴ Starting as a wealth management specialised institution, BCP was quickly transformed into a large retail bank. Taking advantage of stock market developments in the second half of the 1990s, the bank carried out several capital increases, diluting traditional shareholders' positions. In 1995, after a failed attempt in 1994, BCP established a partnership with José de Mello and launched a successful public takeover bid to buy *Banco Português do Atlântico* (BPA), the second largest retail bank, partially privatised at the time. BPA had absorbed *União de Bancos Portugueses* (UBP) when both were State-owned banks, and, after the acquisition operation, BPA remained in BCP while UBP became *Banco Mello*.

In 2000, BCP and *Banco Mello* merged. BCP invested PTE 130 billion to buy 51% of *Banco Mello* and the insurance company *Império*. José de Mello invested PTE 90 billion in BCP and became its largest shareholder, with a participation of 9%.¹⁴⁵ It was the first merger operation involving two listed companies and, in its aftermath, BCP had a market share of 22%. It was also in 2000 that BCP acquired BPSM from CGD and reached the its highest market value – €11.600M.

During the 2000s BCP's expansion was connected to its internationalisation, namely to Greece, Poland, Mozambique and Angola. As an expression of its strength, BCP launched an hostile takeover bid for BPI in 2006, that was rejected by more than 95% of BPI's

¹⁴³ Amorim & Irmãos, *Corticeira Amorim*, Américo Amorim, COLEP, Vicaima, Salvador Caetano, Textil Manuel Gonçalves, Francisco António Fernandes, Vista Alegre, Vitor M. Baltazar Dias Mendes, Constantino Mota & Filhos, Joaquim Ferreira Amorim, *Indústria de Carnes Nobre*.

¹⁴⁴ Jardim Gonçalves was the previous CEO of *Banco Português do Atlântico* and, 'in January of 1985, the socialist tendency in BPA's trade union claimed that the bank was financing the future creation of BCP by the hand of Jardim Gonçalves' (Costa et al., 2011, p.229).

¹⁴⁵ 'BCP e Mello em fusão' in *Público*, 12th January 2000.

shareholders. In the following semester BCP's profits decreased by 22%, partially due to the cost of the operation.

Meanwhile, an internal conflict was triggered in the banking group between Jardim Gonçalves, founder, ex-CEO, and major shareholder, and Paulo Teixeira Pinto, CEO at the time. The largest shareholders took sides, managing their positions in BCP and strategic companies – like Cimpor – according to their interests in BCP. In face of that conflict, BPI, BCP's largest shareholder, proposed a merger between both banks. The offer was refused by BCP. (Annual Accounts, BPI, 2007)

In 2008 BCP lost 60% of its market value. This result reflected the international crisis but also the internal conflict and the recent discovery that previous market results and capitalisation operations that have occurred in 2000 and 2002 were inflated and manipulated through the use of 17 offshore accounts. In short, BCP made use of these vehicles to acquire 4 millions of own stocks financed with own credit and, in that way, influence the market price.¹⁴⁶ As the stock market collapsed in 2002, the €496M in debt were backed by stocks worth €312M, leading to severe losses, concealed by BCP until 2007.¹⁴⁷ In 2008, BPI sold its position in BCP and Sonangol, the National Fuel Society of Angola, became BCP's larger shareholder (9,9%). BCP, on the other hand, sold its position in BPI (9,69%) to Santoro Financial Holdings, owned by Isabel dos Santos, daughter of Angola's former president.

BES – Banco Espírito Santo

The Espírito Santo Group was rebuilt from abroad, in part due to the 'trauma' of nationalisations, but also to benefit from the flexibility offered by legal and tax regimes in countries like Switzerland or Luxembourg. In 1975, the first holding – Espírito Santo International (ESI) S.A. – was founded in Luxembourg, funded with the family's funds, complemented by the investment of emigrants and close families, such as the Queiroz Pereira. In 1976, a second holding was created, also in Luxembourg. Espírito Santo Control SA became the main control holding company, owned exclusively by the family. During the second half of the 1970s, the Espírito Santo family focused on foreign investments: a bank in Brazil — *Banco Inter-Atlântico* —, supported by the military

¹⁴⁶ CMVM - *Processo de Contra-Ordenação n.º 42/2008*.

¹⁴⁷ Records from the Parliamentary Inquiry Committee of Inquiry '*Supervisão Bancária e Financeira*', in 2008.

dictatorship, and several investments in large farms in Latin America, financed by the World Bank. In 1977 the proceeds from selling one third of *Banco Inter-Atlântico* were invested in a wealth management firm in Lausanne – *Compagnie Financière Espírito Santo* — and a minority shareholding in the Biscayne Bank in Florida. The complex shaping of Espírito Santo’s corporate structure continued throughout the 1980s. Espírito Santo Resources Ltd. was created in Nassau, Bahamas, to manage non-financial participations, whereas Espírito Santo Financial Holding, in Luxembourg, held the group’s financial interests.

The return to the country happened in 1985. The group first acquired the financial company FINC — *Sociedade Promotora de Investimentos*, then transformed in ESSI — *Espírito Santo Sociedade de Investimentos*, in a partnership with UBS and the Kredietbank. In 1986, it launched a new bank – *Banco Internacional de Crédito* – with Credit Agricole, and diversified its investments: real estate and tourism, food retail chains, agribusiness in Africa and South America, and some industrial activities. After the Constitutional change of 1989, the Espírito Santo family could finally reassume control over its historical companies. Hence, the insurance company *Tranquilidade* was bought in 1989, in association with Credit Agricole under a new holding company – PATRAN SGPS. The same partnership emerged three years later in BESPARGPS, also aggregating other smaller investors – Maria Cristina Mello, Champalimaud, Americo Amorim, Salvador Caetano – to buy BESCL.

Espírito Santo’s diversification strategy included investments in communications (Portugal Telecom), an airline company (*Portugália*) founded in 1991, a trading company in Angola (ESCOM), several agribusinesses in Africa and Latin America, tourism projects, real estate property, large retail firms (share in *Carrefour*) and construction (Opway).

In 2007, the Espírito Santo Group was the largest and most diversified economic group in Portugal, with a complex structure of holding companies that resembles much the previous mixed conglomerates. In the same fashion, the group had one financial arm – Espírito Santo Financial Group - and one non-financial arm – centred around Rioforte (see Figure Ap. 2). In 2014, Banco Espírito Santo filed for bankruptcy, after admitting its incapacity to redeem all of Group’s securities sold at the bank’s counters in the previous years. According to the report of the Parliamentary Inquiry Committee, the group was in near bankruptcy since 2013, with total liabilities worth €8.9B.

Banco Pinto & Sotto Mayor, Banco Totta, and Santander Totta

António Champalimaud negotiated his coming back to the country through the privatisation of *Mundial Confiança*, *Banco Pinto & Sotto Mayor* and *Banco Totta & Açores*. The specific outline of these operations motivated two polemic parliamentary inquiry committees. One of them concluded for an active role of the government to favour Champalimaud in these privatisation processes. According to the Communist Party's explanation of vote¹⁴⁸, generally corroborated by the Prime Minister,¹⁴⁹ António Champalimaud obtained a compensation deal of PTE 18,6 billion, paid by Cimpor¹⁵⁰ and *Banco Pinto & Sotto Mayor* (BPSM). Furthermore, the State dropped the charges against the capitalist for diversion of funds before 1975.¹⁵¹ Using compensation money, Champalimaud acquired 51% of the insurance company *Mundial Confiança*. This operation took place despite limits on the acquisition of shares in blocks.¹⁵² In 1994, *Mundial Confiança* acquired 80% of BPSM, which had absorbed *Sociedade Financeira Portuguesa* in 1991.¹⁵³

Concurrently, the operation to privatise *Banco Totta* was taking place since 1989. In that year the State sold a share of 49%, imposing a limit of 5% to foreign investors. The largest participation (25,25%) was acquired by *Valores Ibericos*, controlled by a group of Portuguese investors led by José Roquette (*Titulos Lusitanos*, 51,1%) and *Banco Espanol de Credito* (Banesto). The State further reduced its share to 15,15% in 1991, 14,54% in 1992 and 13,21% in 1994, and increased the limit on foreign holdings to 10% in 1990 and 25% in 1993. From 1991 on, a group of societies started acquiring small shares of *Banco Totta*, which were kept, traded between them, or sold to other societies directly controlled by Banesto.¹⁵⁴ As was later found out, all these undercover societies had the same beneficial owners – Menezes Falcão and Inácio Ramos – who not only did not report their operations to *Banco de Portugal*, but were also frontmen financed by Banesto to buy Totta's shares. In the end, according to the *Banco de Portugal*, in 1993 Banesto had a direct participation in *Banco Totta* above 25%, the legal limit, and controlled, by indirect

¹⁴⁸ De Carvalho & Filipe (1999) and *Diário da Assembleia da República*, Friday, 11th October 1996 Serie I – N. 108

¹⁴⁹ Plenary session 23rd July 1999, VII Legislative Term, 4th Legislative Session, Serie I – N. 97.

¹⁵⁰ Cimpor was the State-owned company that resulted from nationalisations in the cements sector.

¹⁵¹ De Carvalho & Filipe (1999) and *Diário da Assembleia da República*, Friday, 11th October 1996 Serie I – N. 108

¹⁵² Decree-law 2/92, 14th January.

¹⁵³ Council of Ministers Resolution N. 124/94

¹⁵⁴ These societies were Latus, Zeugma, Ultra, Fides.

links, more than 40% of the total equity.¹⁵⁵ Meanwhile, in 1992, Totta had absorbed *Crédito Predial Português*.

When the fraudulent buying operation to control Totta was uncovered, in 1994, Banesto became insolvent and his CEO, Mario Conde, was arrested in Spain, accused of fraud. The Portuguese authorities then decided that Totta had to be controlled by a stable Portuguese shareholding structure. In Spain, Banesto was absorbed by Santander, while in Portugal the government negotiated its acquisition by Champalimaud. To proceed with the buying operation of 50% of Totta, Champalimaud requested an exemption from the law requiring that any shareholder with a participation above 20% should proceed with a public tender offer for the acquisition of the remaining shares. The government conceded, given the explicit commitment, assumed by Champalimaud, to keep the institution in national hands. In 1996, the remaining 13% of Totta in State hands were also privatised to Champalimaud.

Despite the agreement, in 1999 António Champalimaud decided to sell part of his group – *Grupo Mundial Confiança* – to *Banco Santander Central Hispano* (BSCH). The government tried to stop the operation, alleging that BSCH did not comply with communication obligations for buying operations of more than 10% of insurance companies. The European Commission, on the other hand, authorised the operation, and suspended all measures imposed by the Portuguese authorities, claiming that the merger did not interfere with EU's competition rules, contrary to the government's action. Nonetheless, political opposition to the transaction determined its renegotiation afterwards. BSCH was authorised to acquire the totality of Champalimaud's participation in *Grupo Mundial Confiança* (53%): 53,3% of BPSM, 92,54% of *Banco Totta & Açores* and 70,57% of *Crédito Predial Português*. BSCH agreed to sell its participation in *Mundial Confiança* to *Caixa Geral de Depósitos*, while the latter would then resell Totta and *Crédito Predial Português* back to BSCH.

Santander's control of *Banco Totta & Açores* was the first step in a much deeper transformation in the banking system property structure, which took place in the 2000s.

¹⁵⁵ Report from the Parliamentary Committee of Inquiry - *Apreciação do Processo de Privatização do Banco Totta & Açores*. *Diário da Assembleia da República*, Serie II-B – N. 10, Thursday, 22 December 1994, VI Legislative Term, 4^a Legislative Session.

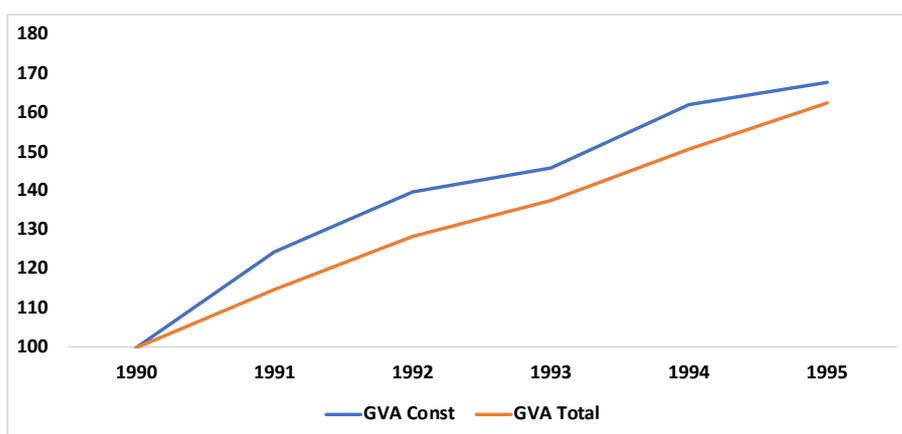
7.6. Non-banking sector: diversification and dependence

With a few exceptions, the major Portuguese non-financial groups were constituted as holding companies controlled by a core group of shareholders, usually within the same family. Under the control of the main holding or holdings, there was a cascade of participations, sometimes organised by sector of activity. Most groups had one core or traditional business area — usually in retail, construction or manufacturing — but based their growth on a large and diversified portfolio of other financial participations. Cross shareholdings with banks or other large groups, namely in the public utilities sector, were frequent. Excluding the Amorim Group, whose main activity remained the production of cork related products (apart from other important financial holdings), and Queiroz Pereira in paper related activities through Portucel, manufacturing activities decreased in the largest conglomerates. Instead, other more profitable activities emerged — retail, construction and real estate —, as result of the growing internal market, tourist activities and political choices favouring the investment in all kind of infra-structures, from transports to education.

7.6.1. Construction and real estate activities

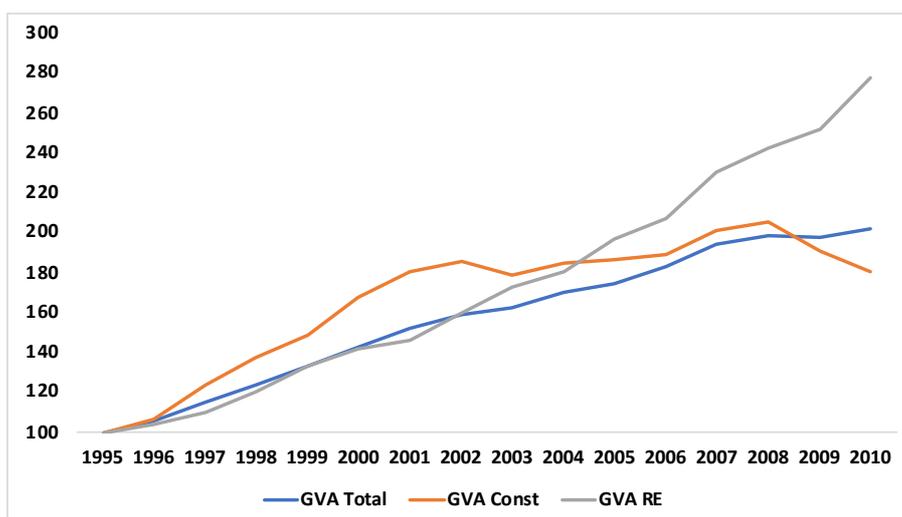
The construction sector reached its peak in 2001, as shown in Figure 24. Statistical data on National Accounts is limited (and non-existent before 1990) and subject to different methodologies across the years. However, it reveals that the gross value added (GVA) associated to construction activities grew well above the overall GVA until 2001. After that, the lack of dynamism in the construction sector contrasted with the growth in the real estate sector.

Figure 23 - Gross value added in the construction sector vs. total economy, 1990-1995



Source: INE. National Accounts. Index number (1990=100).

Figure 24 – Gross value added in the construction and real estate sectors vs. total economy, 1995-2010

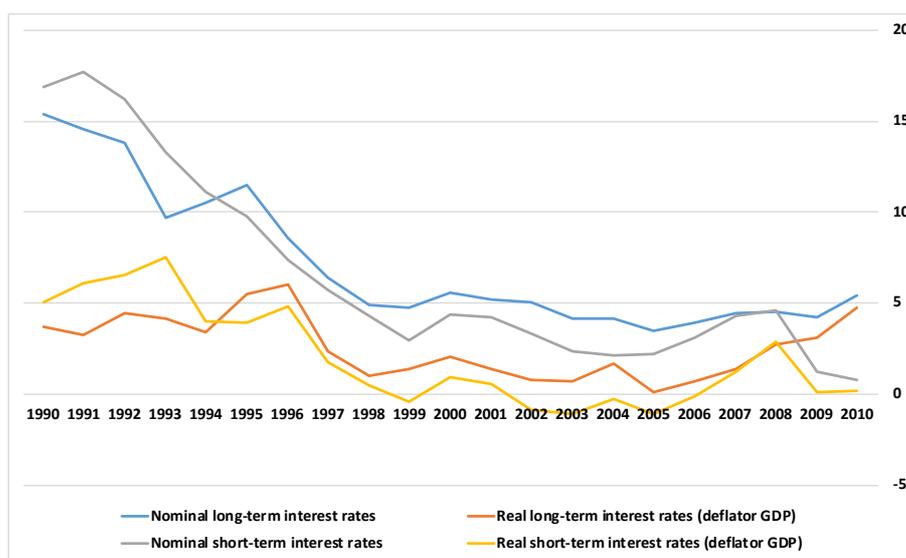


Source: INE, National Accounts. Index number (1995=100)

The interest in construction started in 1983, with the European funds associated to the pre-accession process, mostly directed to the building of infrastructures. Investment in these activities grew at an average rate of 18% between 1985 and 2003, and of 35,6% between 1985 and 1990 (Thames, 2008, p.3). The overall investment in infrastructures under European programmes reached €26,6 billion between 1989 and 2002 (p.3). Apart from the construction of roads and highways, State-owned companies also put forward large investment plans in the utilities sectors – electricity, gas and communications. These projects were partially financed by the banking system, which was looking for higher returns in the context of the late 1980s' historically low real interest rates (see Figure 25).

In the mid 1990s, the perspective of joining the monetary union, linked to financial and capital markets' liberalisation, provided new incentives for the construction sector. The pronounced decline in real and nominal interest rates, mostly after 1995, boosted the demand for domestic credit directed to construction activities. This time, apart from large public spending programmes, such as the Expo 98, the construction and acquisition of residential buildings was also an important factor explaining the growth rates of the sector (Baganha, Marques & Góis, 2002).

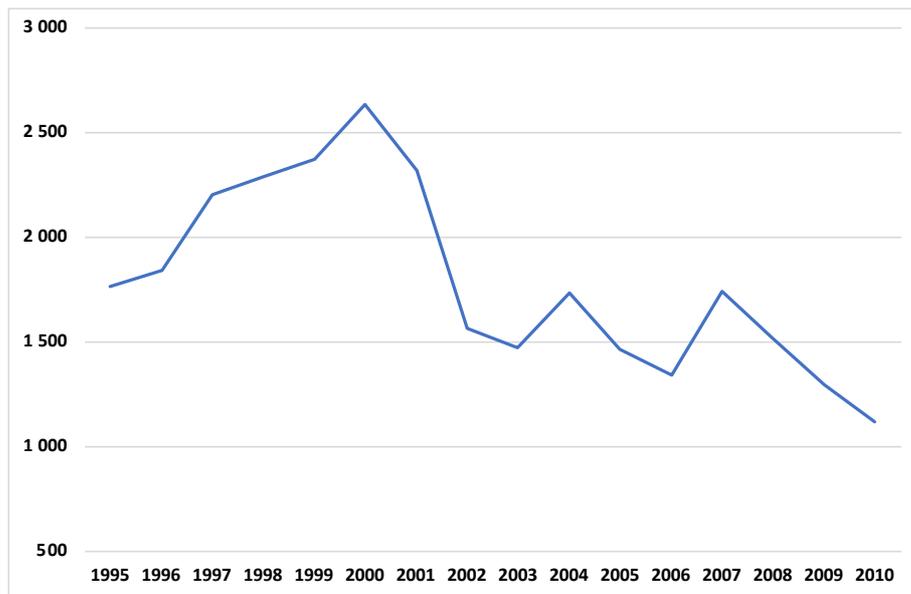
Figure 25 – Interest rates, 1990-2010



Source: AMECO

After the *dotcom* crisis and throughout the 2000s, construction activities dropped, reflecting the overall lack of investment and economic growth. Despite this long-term slowdown, the revenue of the largest corporations in the sector increased between 2000 and 2007 (See Table Ap. 17). Nevertheless, concentration levels were low in the first half of the 2000s, and none of the main groups has had a market share above 10% ever since (AdC, 2006b).

Figure 26 – Gross fixed capital formation in the construction Sector



Source: Pordata. Values in €million, constant prices (2011).

Considering the general lack of investment and economic dynamism in the 2000s, the largest companies' profitability was sustained by a combination of different factors: i) diversification of activities, entering the tourism, real estate and retail markets; ii) internationalisation; iii) large infrastructural projects associated to PPP contracts that benefited four companies in particular – Mota Engil, Somague, Teixeira Duarte and the Espírito Santo Group (Opway); and, iv) a portfolio of participations in listed companies.

The five largest construction groups operating in Portugal in the 2000s were: Grupo Mota Engil, Grupo Teixeira Duarte, Somage, Grupo Soares da Costa, Grupo Opway. In 2016 only Mota Engil maintained its key shareholder (Mota family). The remaining companies went bankrupt (like Opway, owned by the Espírito Santo family) or were subjected to severe downsizing and debt restructuring processes after 2015, under new, mostly foreign, shareholder structures.

Grupo Teixeira Duarte and *Grupo Soares da Costa* are paradigmatic cases of the strategies and interests that dominated the construction sector, as well as of its relation with the banking system.

Construction company Teixeira Duarte S.A. was founded in 1921 by Ricardo Teixeira Duarte. It was listed on the Lisbon stock market in 1998 after its single IPO. The majority shareholder base was kept in the Teixeira Duarte family ever since.

The group was involved in important projects in Portugal before 1974, such as the construction of the Lisbon airport and Assembleia Nacional, but its expansion happened in the 1990s, when, apart from the construction of infrastructures and real estate, it entered other markets and geographies: distribution in Angola; hospitality in Portugal, Angola and Mozambique; car retail in Angola and Portugal; and energy and concessions in Portugal. As with many other companies, in the 2000s international activity was extended to Algeria (2005), Morocco (2005), Brazil (2006), Spain (2004), France (2005) and, later, South Africa (2011), Belgium (2013), Qatar (2015) and USA (2015).

In 1985, Teixeira Duarte was one of the founders and main strategic shareholders of *Banco Comercial Português* (BCP). In exchange, the bank held 10% of the construction company and financed its main operations. That was the case when, in 2001, BCP and *Caixa Geral de Depósitos* (CGD) granted a loan of €410,6 for the acquisition of 10,049% of Cimpor.¹⁵⁶ The strategic importance of the participation in both companies was revealed in 2007, when its stock prices increased by 12%. This movement occurred after UBS targeted Teixeira Duarte's price 33,5% above the market price, due to the valorisation of BCP and Cimpor. These participations were valued in €1,4B in January 2007, the equivalent of their shareholder net debt (€1,4B), and half the value of total assets.¹⁵⁷

During the 2007 shareholder war in BCP, Teixeira Duarte increased its participation in the largest private bank, again financed by CGD, using the stocks as collateral.¹⁵⁸ However, in the following year, the internal crisis and the international financial crash imposed severe losses to BCP, whose market capitalisation dropped from €10.545M to €3.826M. Despite its activity increase (27,6% in turnover and 66,7% in EBITDA in relation to 2007), the construction company reported a net loss of €347M, mainly due to the financial losses associated to its participation in BCP, but also in Cimpor. The impact was also reversed, since BCP was also a shareholder of both Cimpor and Teixeira Duarte. To face the situation of near bankruptcy, given its net debt to equity ratio of 550% (€1.852M), the group was forced to give up the control of its pledged shares in BCP and Cimpor (Annual Accounts, 2007, 2008). In 2010 Teixeira Duarte sold Cimpor's shares to the Brazilian company Camargo Correa, as well as other assets in Portugal.

¹⁵⁶ 'CGD e BCP financiam Teixeira Duarte na aquisição da Cimpor' in *Jornal de Negócios*, 14th June 2011.

¹⁵⁷ 'Teixeira Duarte dispara 12% com recomendação da UBS' in *Jornal de Negócios*, 12th December 2006.

¹⁵⁸ 'Joe Berardo e aliados compram acções do BCP com crédito da Caixa' in *Jornal Público*, 4th January 2008.

José Soares da Costa created a firm specialised in high quality finishing works in 1918, which grew to become one of the largest construction companies after the Revolution. Its expansion occurred in the 1980/90s, when it entered foreign markets (Venezuela, Mozambique, Angola, Iraq, Macau, Egypt, Cape Verde, Guinea-Bissau) and seized the opportunities opened by the new investments in infrastructures. In 1986 Soares da Costa S.A. entered the stock market but remained under the control of the Soares da Costa family. The other relevant shareholders were Salvador Caetano (car retail) and TDP, an instrumental vehicle owned by the Teixeira Duarte family, that also had 10% of Cimpor. In 2002 the group was restructured into one main holding company – *Grupo Soares da Costa* SGPS – and four sub holdings specialised in four areas – construction, specialised industry, real estate and concessions. Two years later, it was revealed that 48% of TDP were already owned by the Manuel Fino family, which had just acquired the remaining shares of TDP. As a consequence, Investifimo S.A. became the owner of 16,8% of Soares da Costa and 10% of Cimpor (AdC, 2003).

Manuel Fino's origins are in the textile sector, protected in fascism years. As Teixeira Duarte, Fino was a close friend and ally of Jardim Gonçalves, the CEO of BCP, and his interests were divided between non-food retail, real estate and financial holdings (mainly a share in BCP).

In August 2006, taking advantage of the 100% rise in the stock prices of *Grupo Soares da Costa*, the family sold its controlling position to Manuel Fino. After a takeover bid in 2006/7, Investifimo's share in Soares da Costa increased to 56,23%. Between 2006 and 2007, Manuel Fino increased his participations in Cimpor (20%) and BCP (2,07%), in a strategy to oppose Teixeira Duarte and Jardim Gonçalves in BCP's internal conflict. As with Teixeira Duarte, these operations were mainly financed by CGD and BCP, backed by the same stocks. On the other hand, BCP used *BCP Gestão de Fundos de Investimento* to increase its participation in Soares da Costa to a maximum of 6,6% in 2007¹⁵⁹.

Fino's financial position deteriorated as his main financial assets lost value in relation to the outstanding debt to the banking sector during 2008 and 2009. CGD demanded new collateral and ended up buying Fino's stocks in Cimpor €62M above the market price to avoid default. Manuel Fino became insolvent in 2011, with unpaid loans of €250M to BCP and €380M to CGD¹⁶⁰. One year later he sold the remaining 10% of his participation

¹⁵⁹ Based on SdC Press Releases available at www.sdcinvestimentos.pt; and AdC (2006a,2006b).

¹⁶⁰ "Manuel Fino a um passo de perder a Cimpor" in *Diário de Notícias*, 4th November, 2011.

in Cimpor to Camargo Corrêa, and lost the control of Soares da Costa to a foreign investor in the context of a debt restructuring operation of the construction group.

In 2013/2014, Soares da Costa changed its trademark to SdC and in 2016 it filed for a restructuring programme to avoid bankruptcy.

7.6.2. Retail, wholesale and distribution

The great expansion of major wholesale, distribution and retail chains dates from the 1980s, as a response to the increase in private consumption and overall economic environment. Two Portuguese groups stand out in this period: *Grupo Jerónimo Martins* and *Grupo Sonae*. Their core business had a particular focus on food retail activities but also included trade in non-durable and long-term consumer goods, through a vast network of specialised shops, supermarket chains and department stores.

According to *Autoridade da Concorrência* (AdC, 2010), in 2008, the largest retail groups had a market share of 85% and, out of that, the two largest groups – Sonae and Jerónimo Martins — controlled 45% of the market. This share increased throughout the 2000s, as well as total sales in the retail sector (32% between 2002 and 2008), which represented 7,3% of the GDP in 2008.

Sonae was already the largest non-financial private group in 1990. Its core business had transferred from wood and laminated products to retail. Besides the Modelo/Continente hypermarkets, between 1990 and 1999, the Group invested in different brands of specialised retail — Worten, Sport Zone, Max Office, Modalfa, and Mazmat. In 1995, it opened a large net of health clubs. *Sonae Imobiliária*, created in 1989 as a retail real estate company, promoted and managed eleven shopping centres in the country, including *C.C. Colombo*, the largest shopping centre in the Iberian Peninsula. The Group also invested in tourism, with the constitution of Sonae Turismo in 1994.

One of Sonae's group investment priorities was communications. This being so, it created Sonaecom (1994), which aggregated several investments in the sector: *Público*, the leading national daily newspaper; Optimus (1998), the third mobile phone operator in partnership with EDP and France Telecom; Novis (1999), a landline telecom company,

and Clix (1999), an Internet service provider.¹⁶¹ In 2000 Sonaecom launched an IPO and was listed in the Lisbon Stock Exchange.

The group also had some manufacturing and industrial interests, namely in the paper and pulp business. According to its Annual Report, Sonae's strategic plan, forged in 1996, was 'to try to lead a national project to optimise the income in the forest sector' based on the privatisation of Portucel and Soporcel.¹⁶² After a failed attempt to acquire a strategic participation in the first stage of Portucel's privatisation, Sonae managed to control a participation of 10% in the stock market in 1998. Its request to further increase that shareholding was denied by the government. In the next year, the group also acquired a participation in Soporcel's IPO and 65% of Gescartão (part of Portucel), in a joint venture with Europac. In the financial sector, Sonae had a participation of 4,33% in BPI.

In 2001, the Sonae Group was divided in five holding companies: *Sonae Industria*, *Modelo Continente*, *Sonae Imobiliária*, *SonaeCom*, *Sonae Turismo*, *Sonae Capital*. 58% of its total turnover was concentrated in retail and distribution activities, 23% in wood panels and 11% in communications. The total consolidated net debt of SONAE was 579% its EBITDA, giving a debt-to-capital ratio (or financial leverage) of 79%.

Grupo Jerónimo Martins was less diversified than Sonae, with a clear focus on food retail activities. Its origins are in the Manuel dos Santos family, who owned a chain of retail shops back in 1953. Its growth in the 1980s was linked to the expansion of supermarkets *Pingo Doce*, established in partnership with Delhaize (second largest Dutch retailer), which was replaced by another Dutch partner – Royal Ahold NV –, owner of 49% of *Jerónimo Martins Retalho*, the retail holding company, in 1992. The group was also the largest shareholder of *Recheio*, leader in the wholesale market.

In 1989 the group (*Jerónimo Martins SGPS*) entered the stock market through an IPO of 15% of its capital. The portion of shares in free float increased throughout the years but the Soares dos Santos family remained as the controlling shareholder. Between 1994 and 1999, *Jerónimo Martins*' stock prices raised by 1000%, as the group diversified its activities and geographies – supermarkets *Sé* in Brazil, sports equipment with *Lillywhites* in the UK, supermarkets, cash and carry and discount stores in Poland, beverages, a partnership with BCP to create *Banco Expresso Atlântico*, and a participation in *Oniway*,

¹⁶¹ 'Novis e provisões afectam resultados da Sonae.com; prejuizos agravam-se em 76%' in *Jornal de Negócios*, 20th February, 2002.

¹⁶² *Comunicado Reprivatização Portucel* to CMVM by Sonae, 4th July 2003.

a telecommunications company controlled by EDP. As a consequence, between 1996 and 2000, the group's debt went from €67M to €1536M, corresponding to a gearing ratio of 349% (Silva Dias, 2009). The leverage levels, combined with the *dotcom* crisis, determined heavy losses for Jerónimo Martins in 2000, 2001 and 2002. To overcome the crisis, the group was restructured in two holding companies: *JM Distribuição* SGPS, for participations in the retail sector, and *JM Investimentos* SGPS, for financial participations.¹⁶³ Until 2004, the group sold all its non-strategic holdings, apart from the profitable retail businesses in Portugal – Pingo Doce – and the discount chain in Poland – Biedronka. In Poland, Jerónimo Martins was charged with being the symbol of workers' rights abuse by the Helsinki Foundation for the Human Rights.¹⁶⁴

The market capitalisation of Jerónimo Martins increased from €667M in 2002 to €3.391M in 2007, and Alexandre Soares dos Santos' fortune has been consistently appointed as one of the two largest in Portugal.¹⁶⁵

7.6.3. Amorim and the Mello families: new fortunes, old fortunes and the central role of the banking system

Américo Amorim's Group was created around *Corticeira Amorim*, founded in 1953, and world leader in the transformation of cork and production of cork stoppers, composite cork, cork board, expanded isolation and cork floor and wall coverings.

Although cork always remained the Group's core activity, Américo Amorim relied on other businesses to become the richest person in Portugal in 2010 according to *Revista Exame* and enter the Forbes list of world billionaires in the 200th position in 2011. His expansion is firstly associated to the banking sector and then to real estate activities and a very profitable share in Galp.

In 1981, Amorim was one of the founders and key shareholders of SPI (the precursor of BPI). Displeased with SPI's decision to remain as an investment bank, Amorim joined the business syndicate that created BCP in 1985, with a participation of 20%. However, once again, the strategic interests of Américo Amorim – joining the board of directors – collided with BCP's CEO's (Jardim Gonçalves) view of increased autonomy towards the

¹⁶³ 'Crise na Jerónimo Martins obriga à divisão do grupo em dois' in *Público*, 30th March 2011.

¹⁶⁴ 'ONG denuncia "transgressões" na rede de supermercados Biedronka' in RTP, 25th April 2006.

¹⁶⁵ 'Análise Fundamental à Jerónimo Martins' in Borja on stocks, 17th February 2017.

shareholder base.¹⁶⁶ Hence, in 1993, Amorim sold 10% of its 38% participation in BCP to Banco Central Hispano for PTE32 billion, which were invested in creating *Banco Português de Negócios* (BPN) and *Real Companhia de Seguros*.¹⁶⁷ In 1997, Amorim sold his participation in BPN and founded *Banco Nacional de Crédito*, after losing the privatisation of *Banco de Fomento Exterior* to BPI¹⁶⁸. This share of 75% was traded in 2003 for 4,5% of Banco Popular.

After leaving BCP, Amorim took part in the 1990s communications boom through Telecel, a joint venture with the Espírito Santo Group, which, in turn, was also a shareholder of Portugal Telecom, the sole owner of TMN (Telecel's direct competitor). In 1996, after Telecel's IPO, the participation of 62,5% is reduced to 10%, also sold one year later, with a profit of 666%.¹⁶⁹

It was also in the early 1990s that Amorim entered the energy sector through Petrocontrol, which acquired a participation in Petrogal's privatisation process. As described in section 7.3, the holding was sold in the year 2000. Amorim returned to that sector in a subsequent privatisation operation of Galp in 2005, in a partnership with Sonangol. The connection with Isabel dos Santos was extended to *Banco BIC Angola*, formed in 2005, and to *Imoluanda* and *Cimangola*, a real estate and cements company respectively.

In Portugal, Amorim was one of the largest property owners in Lisbon, in part through *Amorim Imobiliária*, a real estate company with a focus on the construction and exploitation of shopping centres (*Dolce Vita*), that was sold to *Inmobiliaria Chamartín* in 2007.¹⁷⁰ The Group also had interests in the textile sector (Velpor), tourism and the banking sector, through the investment bank *Banco Carregosa*.

Despite the importance of *Corticeira Amorim* as the central industrial piece of Amorim's Group, its leadership was passed on to the second generation (a nephew) in 2001. Américo Amorim maintained the control of the family's financial holding companies, where the largest, and most profitable, participations were parked.

¹⁶⁶ 'O homem que sonhava ter um banco mas que descobriu petróleo' in *Observador*, 13th July 2017.

¹⁶⁷ *Banco Português de Negócios* results from the merger of Norcrédito and Soserfin (35% belonging to Amorim) – 'Sempre com um pé na banca' in *Público*, 11th December, 2005.

¹⁶⁸ *Resolução do Conselho de Ministros* 132-A/96, 23rd August.

¹⁶⁹ 'O "eterno" Américo Amorim' in *Jornal de Negócios*, 17th July 2017.

¹⁷⁰ "Américo Amorim 1934-2017: cronologia de um homem e um grupo" in *Expresso*, 13th July 2017.

CUF Group had been mostly nationalised, and it never recovered either in size nor form. The two main heirs, José de Mello and Jorge de Mello, returned to the country before 1980.

José de Mello started by creating a financial consulting company (MDM) with the Morgan Guarantee Trust Company of New York and the Deutsche Bank AG. He also had a share in a Swiss bank, a German insurance company, and controlled CUF Finance, a wealth management firm in Genoa. Aside from a share in Lisnave, his first industrial investment was UNITECA (chemicals).¹⁷¹ Both companies, as well as other industrial firms acquired during the privatisation process, were aggregated in SOGEFI – *Sociedade Geral Financeira, S.A.*, under the control of José de Mello SGPS, founded in 1983.¹⁷² In 1988, José de Mello created a new holding company to manage his financial interests – *União Internacional Financeira, S.A.* During the first years of the 1990s, José de Mello also acquired *Sociedade Financeira Portuguesa – Banco de Investimento, S.A.* (banking), *Companhia de Seguros Império* (insurance) and SOPONATA (the last two companies were part of the CUF Group). It also created Neofisa – *Serviços Financeiros S.A.*, specialised in financial services and investment projects. *Sociedade Financeira Portuguesa* was transformed in *Banco Mello* in 1991, and absorbed *União de Bancos Portugueses* in the privatisation process of 1995. In 1997, the José de Mello Group constituted QUIMIGEST – *Sociedade Química de Prestação de Serviços S.A.*¹⁷³ to bid in tenders for the privatisation of 90% of QUIMIGAL.¹⁷⁴ One year later, José de Mello sold 50% of *QUIMIGAL Adubos* to SAPEC, SGPS and the company changed its denomination to ADP – *Adubos de Portugal*. This company would then buy and aggregate several fertiliser firms from both José de Mello and SAPEC Groups. Chemical companies belonging to QUIMIGAL, SGPS were aggregated under CUF, recovering the name of the historical group, albeit with a very different dimension.

Besides the traditional CUF business areas, in 1995 the José de Mello Group entered a new activity, which would prove pivotal to its growth and accumulation strategy – healthcare services. Using the experience of the old CUF Hospital, built for workers and their families, the group obtained the concession to run a large public hospital in 1995.

¹⁷¹ José de Mello kept a small personal share in Lisnave that, with the support of other foreign shareholders, gave him management powers in the company during the nationalisations period (Amaral, 2015).

¹⁷² *Programa de Emissões de Papel Comercial*, June 2011 – José de Mello SGPS.

¹⁷³ Shareholder structure: 40% SOGEFI, 27% Neofisa and 20% SAPEC Portugal, SGPS.

¹⁷⁴ In 1989, the government proceeded to the financial and operational restructuring of QUIMIGAL. This process included: 67% reduction of employed personnel; capital injection of PTE48 million, resulting in a positive equity of 5.7 million instead of the previous negative 41.5 million; closing of obsolete plants and reorganisation of the corporate structure under the model of holding companies (GAFEEP, 1995, p.95). Privatisation started in 1997.

Three years later, a new holding company was created to manage the group's interests in the health business (*José de Mello Saúde, SGPS*).

Towards the end of the 1990s, the José de Mello group focused chiefly on three areas: financial activities (*Banco Mello* and several other financial companies), chemical activities (CUF), and the developing healthcare services (*José de Mello Saúde*). In 2000, *Banco Mello* merged with *Banco Comercial Português*.

Jorge de Mello, on the other hand, focused on typical industrial activities. In 1982, he made use of his compensation titles to buy ALCO – *Algoadeira Comercial e Industrial*, operating in the transformation of oilseeds. In 1983, he created his first holding in the country – RIPONE SGPS. In the early 1990s, the Jorge de Mello Group used two participated holdings – Mellol SGPS and GJM SGPS, Lda – to join the privatisation process. Apart from SOVENA and ALCO, both agribusiness companies, Jorge de Mello invested in the State holding Nutrinveste, leader in the agribusiness sector. In 1996, he acquired 20% of the 65% share in *Tabaqueira* with the multinational Phillips Morris and, in 1999, an additional share of 20% of the 25% for sale. By the year 2000, Jorge de Mello sold his share in *Tabaqueira* to Phillip Morris and focused mainly on Nutrinveste.

This new capitalist class hosted newcomers – Sonae, Jerónimo Martins, Amorim – and old fortunes – Espírito Santo, Champalimaud, Mello, Queiroz Pereira. All kept their family base, respecting the aristocratic tradition of the Portuguese bourgeoisie, and all benefited from policies designed to favour the creation of a capitalist class – themselves.

In one way or another, these groups took advantage of the ongoing processes of financial liberalisation and privatisations. The interest in privatisations was motivated by different goals, depending on the characteristics of each company and the strategy of its shareholder group. In some cases, like Petrocontrol's participation in Galp, the purpose was mostly to obtain short-term capital gains in favourable tax conditions. In other situations, like Espírito Santo's participation in Portugal Telecom, or Amorim's in Galp, shareholders were mostly concerned with their remuneration in the form of dividends and stock buybacks. Finally, the control or influence over these crucial companies, operating in protected regulatory environments, deepened political relations and facilitated plans for internationalisation.

Section 7.3 showed how Portugal Telecom, EDP, Galp and Cimpor were used as centres of power in a constellation dominated by banks and their strategic interests. These companies controlled important national infrastructures and dominated the internal market and valuable reputational and physical assets abroad. Their boards of directors were authentic revolving doors to the political sphere and hosted a large number of ex-government officials. Last but not the least, these companies were entitled to great monopoly profits and an endless indebtedness capacity, both mobilised to finance shareholders and support their expansion strategies and disputes.

The banking system was deeply involved in privatisations. The development of new private banking groups – BPI and BCP – and the selling of the ones which had been nationalised – BES, BPSM, BTA — were pre-conditions to creating business syndicates capable of running for the remaining companies being privatised. Privatisations became an important line of business, in which banks participated as shareholders, acquiring strategic stakes in important companies, as financial advisors to sellers and institutional buyers, and as financiers.

The rapid growth of the banking sector is explained by two other strategic choices. The first was made in the 1990s: to expand their client base, with an overflow of loans for housing and construction purposes. The second was made in the 2000s: to focus on

project finance, provided by the surge of PPP contracts and prevalence of stock market restructuring operations.

As with privatisations, PPPs opened new lines of business, not only for banks, but also, and specially, for construction companies. Moreover, these contracts, analysed in section 7.4, established new rents, corresponding to the difference between the investments undertaken and future financial payments assumed by the state.

The existence of rents, in particular monopoly rents, seems to have had an instrumental role in the Portuguese business structure. As has been shown, in the absence of other type of industrial policies, the largest Portuguese capitalists mobilised their financial and political resources around very specific sectors — banking, construction, energy, and communications. The focus on retail activities – the core of Jerónimo Martins and Sonae groups – is explained by similar reasons: a very concentrated sector, based on the internal market, where companies are price-makers, as they impose their markups both to consumers and producers alike.

This economic structure – inherently fragile and prone to stagnation – results from a convergence between the pecuniary and strategic interests of the Portuguese capitalist class and political decisions in the context of financial and economic liberalisation.

The concentration of profits and credit in the rentist sectors created a bias towards these activities. Furthermore, the general lack of interest for investment was aggravated by the largest companies' decision to direct an important part of their investment capacity abroad, due to the domestic state of excess capacity.

Overall, rentist profits and financial resources were appropriated by large economic groups, that were not focused on the development of the country, or even their own productive capacity, but interested on enlarging their power and ensuring their access to rentist profits.

The cases of Portugal Telecom and Cimpor are glaring instances of capitalist sabotage at firm level. The reasons for their decay are not to found in economic theory, not even in crowding out and internal means of finance effects, described in Post Keynesian literature. It goes beyond the diversion of management decisions towards short-term financial gains – it applies all companies analysed –, inasmuch as these companies were deliberately endangered by the political and economic interests of their shareholders.

The 2000s were marked by shareholder disputes and financial acquisitions that occupied and indebted the largest Portuguese companies and their shareholders. The banking sector was an important participant in that process, with the acquisition of strategic stakes in non-financial corporations. The resulting ownership structure was far from the traditional mixed conglomerates – maintained only by the Espírito Santo Group. However, the level of interconnectedness between the country's largest companies raised the levels of systemic risk.

Finally, although this was not the focus of the investigation in the present chapter, it should be added that the other side of rentist profits associated to privatised companies and policy decisions was the misdirection of public funds with potential alternative productive uses.

Overall, this chapter made use of an extensive and detailed analysis of very concrete cases to show how the accumulation and concentration strategies of large capitalist conglomerates have contributed to generate a fragile and weak economy through sabotage.

In its structure, the explanation for stagnation that emerged out of this institutional analysis confirms the theories proposed by Kalecki and Steindl, in which the lack of investment and growth are the consequences of the process of concentration of surplus in large oligopolistic companies in relation to their capacity or willingness to invest. It is an institutional and political illustration of the conditions that led to stagnation. The same problem will be analysed from a macroeconomic perspective in the next chapter.

8. Profits without investment in the Lost Decade

8.1. Introduction

The purpose of this chapter is to explore stagnation through sabotage from a macroeconomic perspective, as suggested by Kalecki and Steindl. Recall that the term sabotage is used to refer the negative effects that emerge out of the process of concentration and accumulation of capital.

The underlying hypothesis is that, due to the process of concentration and accumulation of capital, large companies and conglomerates were able to appropriate the largest shares of the surplus generated in the economy. The main mechanisms supporting the unequal

distribution of surplus, explained in chapters 5 and 7, are the access to monopoly rents, the privileged capacity to accede and exploit financial markets, and the transmission of capital through family networks.

However, the share of appropriated surplus is relatively larger than these conglomerate's capacity or willingness to invest in fixed assets, aggravated by a situation of excess capacity.

The majority of firms in the economy are small and medium enterprises which will invest under their putative intentions. Their size makes them relatively more dependent on the accumulation of profits, appropriated by large groups. In the absence of sufficient internal funds, these firms will have to rely more on external debt financing, becoming more permeable to changes in financial markets and less capable of securing future investments.

In the absence of counter forces, such as large public investment programmes, the combination of these simultaneous effects pushes to a cumulative situation of higher indebtedness, financial fragility and lower investment.

This theoretical formulation, proposed in chapter 4, seems to apply to the Portuguese economic structure. Large companies were allowed to combine bank loans with other types of market debt, namely bonds. This long-term debt was not channelled to productive investments in the country, but to finance their international expansion, shareholder remuneration schemes and restructuring operations, such as mergers and acquisitions. This period of euphoria was fuelled by a wave of privatisations of profitable State-owned companies in strategic sectors, like energy and communications, and by the opening of financial and capital markets following the process of European monetary integration.

The majority of companies, on the other hand, still relied on short-term bank loans to manage their liquidity. As debt increased relatively to the accumulation of profits, these firms' investment capacity was weakened, causing total investment to stagnate. Furthermore, these companies' financial fragility made investment more volatile and dependent on the existing financing conditions.

The empirical investigation motivated by these theoretical hypothesis carries numerous difficulties. Contrary to larger countries, like the United States, where statistical data is widely available, covering a broad number of indicators and historical periods, the study

of a small economy, like Portugal, cannot ignore the methodological restrictions brought by limited data.

Economic data for Portugal suffers from two major limitations: lack of some specific indicators and methodological inconsistency in the organisation and presentation of the data that does exist. To overcome these limitations, it was necessary to resort to proxies, selected from the indicators available, and ratios, to avoid, as much as possible, the complex price effects that emerge from different deflators and euro/escudo conversion rates. Other structural problems, derived from permanent changes in statistical models or in the forms of presenting the data, could not be avoided, and should be taken in consideration when interpreting the results.

The following sections in this chapter resort to two data sources: National Accounts for the non-financial sector, desegregated by firm size, published by INE and the Sector Tables long time series, provided by *Banco de Portugal*. Both these sets of series are available only since 1995/1996 and suffered important methodological changes since then. National Accounts allows to explore the relation between profits and investment for different groups of companies according to their size. However, the method used for classifying companies changed in 2004, making direct comparisons more difficult. Furthermore, proxies for profits in National Accounts do not consider important financial aspects, such as interest payments or dividends received. Data from the Central Balance Sheet Database – or Sector Tables – from the *Banco de Portugal* provide additional and original information on firms' financial conditions, also disaggregating for company size. This database allows the comparability of concepts throughout the period under analysis; however, a drastic change in the method of collecting information at enterprise level occurred in 2006 and must be acknowledged in the analysis.

The characteristics and limitations of these databases as well as the choice of indicators and concepts will be discussed in detail throughout the next sections.

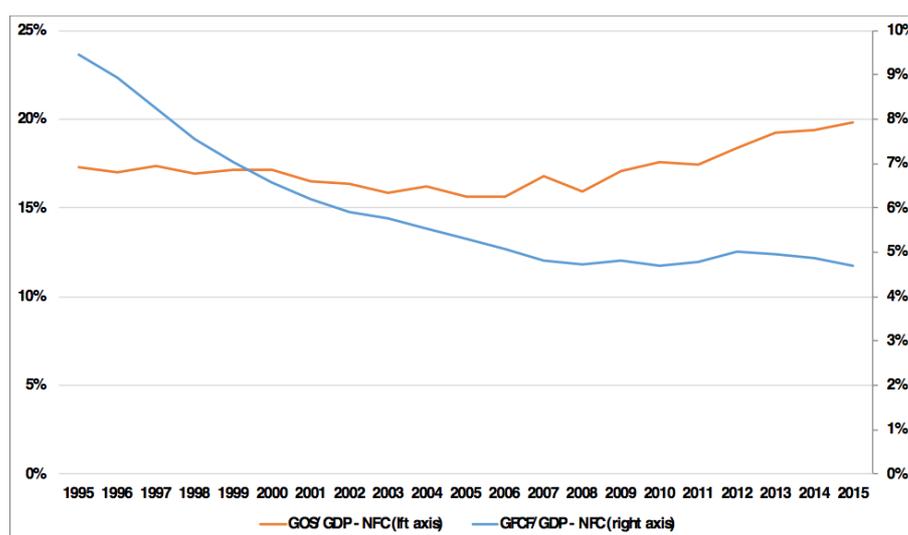
Section 8.2 provides an introductory analysis of the evolution of the capital share, paying particular attention to the relationship between profits and fixed investment. Section 8.3 discusses the evolution of concentration levels in the Portuguese non-financial business structure, identifying the relative weight of different sized companies to overall employment and turnover. Section 8.4 analyses the impact of the prevailing levels of concentration on profits and investment, to determine the existence of a distributional problem, as suggested in the literature. Section 8.5 adds an assessment of the financial

conditions faced by different types of companies, relating their financial fragility to investment. Section 8.6 concludes.

8.2. Capital share, profits and investment in the non-financial corporate sector

Between 1995 and 2005, the gross fixed capital formation of non-financial corporations dropped from 10% of total GDP to 5%. Figure 28 shows that this decline was not reflected in the capital share of income, measured by the ratio between gross operating surplus (GOS)¹⁷⁵ and GDP, which remained constant around 17%, except for the *dotcom* crisis and the first year of the crisis, when it fell to 16%. During the recession, the capital share increased from 16% to 20% of the GDP, reflecting the redistributive impacts of the internal deflation strategy based on austerity programmes.

Figure 28 - Investment and capital share of GDP for the non-financial corporate sector

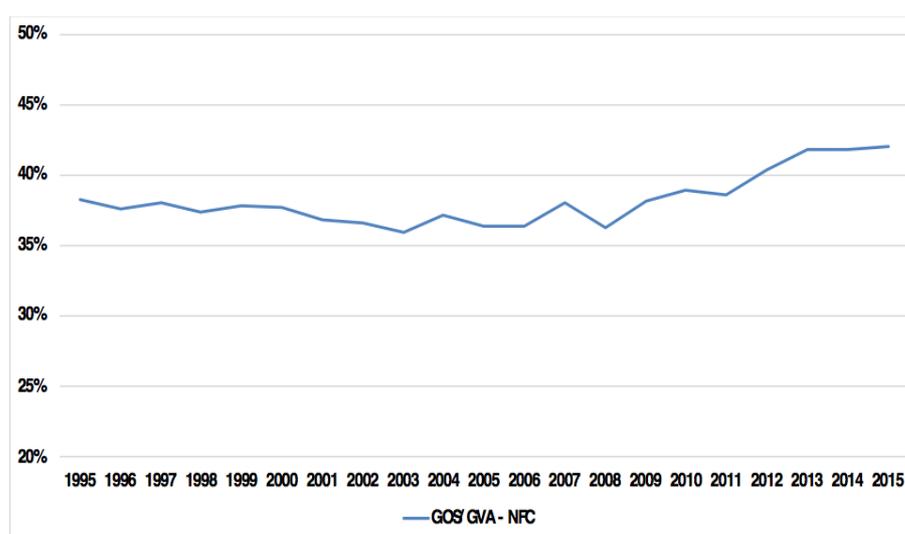


Source: INE

An alternative way to evaluate the evolution of the capital share in the non-financial corporate sector is through the share of GOS in GVA, given by the value of output minus intermediate consumption. Figure 29 shows that, despite the slight decline of 0,2pp in the first years of the 2000s, during the *dotcom* crisis, the GOS/GVA ratio was also largely stable until the Great Recession.

¹⁷⁵ GOS equals total output minus intermediate consumption, taxes on production net of subsidies, and compensation of employees.

Figure 29 - GOS/GVA ratio for the non-financial corporate sector



Source: INE

The reading of both these measures of the capital share depends on the meaning attributed to capital. Based on the neoclassical production function, the capital share is often interpreted as the cost of capital as a production factor. Hence the idea that a decline in the interest rate (cost of capital) could lead to shift towards more capital-intensive production. This thesis is disproven by the Portuguese combination of low interest rates and fixed investment.

However, if capital is not considered as an instrument of production, but the income accruing to property owners, the capital share of an economy may be unrelated to its stock of capital.

To address this question, the model proposed by Barkai (2016), that estimates the profit share of GVA based on the cost of the stock of capital in use in production, was adapted to the data limitations for the Portuguese economy and simplified to a basic theoretical exercise. Consider the following equation:

$$P_t^Y Y_t = w_t L_t + t_t Y_t + R_t P_{t-1}^K K_t + \Pi_t \quad (11)$$

$P_t^Y Y_t$ is the value of production in a certain year, or the nominal value of GVA in that year, $w_t L_t$ is the wage rate applied to the total number of workers, or the total wage spending in the National Accounts, $t_t Y_t$ represents taxes on production as in the National Accounts. R_t is a measure of the cost of capital, $P_{t-1}^K K_t$ is the stock of capital available for production in t (or the stock at the end of $t-1$), valued at prices of $t-1$, and Π_t represents profits in t . Therefore,

$$P_t^Y Y_t - w_t L_t - t_t Y_t = GOS \quad (12)$$

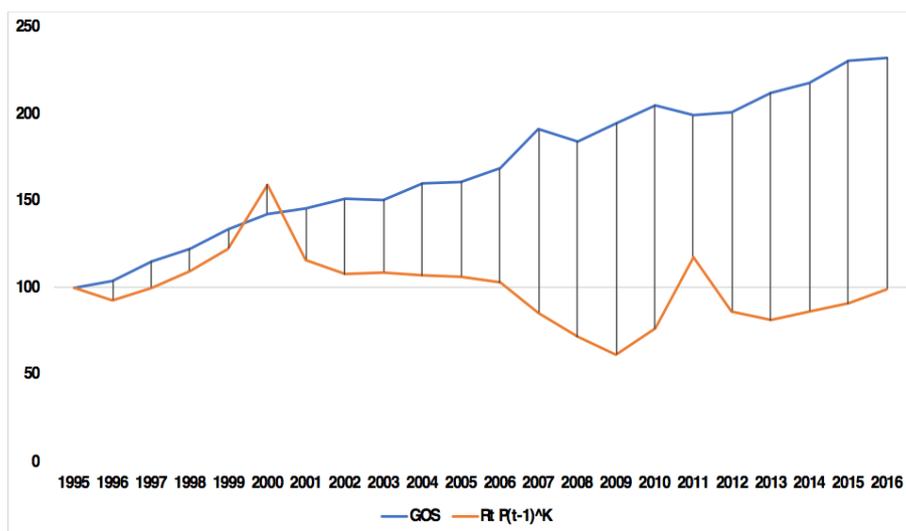
And,

$$GOS = R_t P_{t-1}^K + \Pi_t \quad (13)$$

So that Π_t is obtained by extracting the cost of financing the entire stock of fixed capital in use from GOS. GOS for non-financial corporations is obtained directly from the National Accounts, as the nominal stock of capital for non-financial companies. R_t is the cost of financing of non-financial companies, obtained from the *Banco de Portugal* Sector Tables, as the relation between interests payments and debt financing. To avoid the difficulty of dealing with stock market data (only available from 2002 on) to estimate the market cost of equity, and considering that market financing is residual in Portugal, it is assumed that non-financial companies finance their stocks of capital only through debt.

Figure 30 presents the evolution of GOS and the cost of capital as an index number between 1995 and 2016, so that the area between both lines corresponds to profits, or the part of GOS not used to finance fixed capital. After a peak in 1999, expenditures on fixed capital decreased continuously in relation to GOS, indicating higher profit rates in the non-financial sector.

Figure 30 - Profit and Capital Shares in the non-financial corporate sector



Source: INE. Note: Own Calculations based on Barkai (2016); Index number (1995=100).

Despite the lower average investment and growth levels in the 2000s, there is no indication of a corresponding decline in the profitability of the non-financial sector.

Furthermore, the violent contraction in economic activity in the first half of the 2010s brought about a relevant increase in capital share in the non-financial corporate sector.

In short, it appears that, not only have profits been detached from investment, but also that firms were able to sustain profits despite the context of stagnation or recession. These preliminary findings corroborate the hypothesis of concentration of market power and surplus in large firms with lower propensity to invest.

8.3. Concentration in the non-financial corporate sector

Table 7 and 8 show the concentration of enterprises in Portugal, by dimension, between 1996 and 2016. The two tables are not directly comparable due to a change in the methodology used by INE. Before 2003, companies' dimension was measured solely through the number of workers, as presented in Table 7, while, after that, turnover and total balance sheet value were also introduced in the classification. Therefore, in Table 8, micro, small and medium enterprises (SME) refer to companies that employ less than 250 workers, with a turnover of less than €50M or with a balance sheet value of less than 43 million euros, which is the criteria for medium enterprises. Micro enterprises employ less than 10 workers and have balance sheet or turnover values under 2 million euros, and small enterprises are those with less than 50 workers, a turnover or balance sheet value not exceeding 10 million and that are not classified as micro enterprises. In both tables, the percentage of each category of enterprises is calculated for three indicators: number of enterprises, number of persons employed and value of turnover.

Despite the different dimension categories, the concentration of the Portuguese economy not only stands out in both tables but seems also to have increased in the two decades under analysis. In 1996, companies with less than 20 workers represented 96,7% of the total number of companies, but 46,8% of the total turnover. Companies with more than 100 persons employed were 0,5% of the total but generated 32,8% of the turnover. In 2016, 92,6% of the enterprises in the country were micro enterprises (less than 10 employees or €2M of turnover or balance sheet value) that generated only 21,6% of total turnover. Large enterprises (more than 250 workers or than €50M of turnover/43 million balance sheet value) were responsible for 39,3% of total turnover. Statistics also indicate that the contribution of smaller enterprises to total employment is much larger relatively to output.

Table 7 - Concentration measures, 1996 - 2003

		1996	1997	1998	1999	2000	2001*	2002	2003
<20 workers	% of Enterprises	96,7	96,9	96,9	96,9	96,9	92,1	92,3	92,6
	% of Persons Employed	54,9	55,5	51,5	49,8	49,6	37,8	39,1	40,4
	% Total Turnover	46,8	48,0	43,7	37,4	36,0	30,8	30,6	31,3
20-99 workers	% of Enterprises	2,8	2,7	2,7	2,6	2,6	6,8	6,7	6,4
	% of Persons Employed	19,8	19,3	21,2	21,4	21,4	27,0	26,2	26,3
	% Total Turnover	20,4	19,7	22,4	24,0	23,2	26,0	25,4	25,1
>99 workers	% of Enterprises	0,5	0,4	0,4	0,4	0,4	1,1	1,1	1,0
	% of Persons Employed	25,3	25,2	27,3	28,8	29,1	35,3	34,6	33,3
	% Total Turnover	32,8	32,3	33,9	38,6	40,7	43,2	44,1	43,6

Source: INE. Note: *In 2001 uninominal enterprises were excluded from the statistics.

Table 8 - Concentration measures, 2004 - 2016

		2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
Micro Enterprises	% of Enterprises	95,3	95,4	95,4	95,5	95,6	95,7	95,6	95,7	95,9	96,2	96,3	96,2	96,2
	% of Persons Employed	44,7	45,6	44,8	44,9	45,8	46,1	45,7	45,8	46,4	47,0	46,9	46,4	45,9
	% of Turnover	23,2	23,0	22,1	21,3	20,9	21,5	20,4	19,4	19,0	19,0	19,2	19,3	19,3

Small Enterprises	% of Enterprises	4,0	3,9	3,9	3,8	3,7	3,7	3,7	3,6	3,5	3,2	3,2	3,2	3,2
	% of Persons Employed	21,6	21,3	21,5	21,0	21,1	20,8	20,7	20,3	19,8	19,0	18,9	19,0	19,1
	% of Turnover	21,7	21,6	21,5	21,0	20,8	21,0	20,5	19,9	19,4	19,3	19,5	19,7	19,8
Medium Enterprises	% of Enterprises	0,6	0,6	0,6	0,6	0,5	0,5	0,5	0,5	0,5	0,5	0,5	0,5	0,5
	% of Persons Employed	15,3	14,9	15,0	14,9	15,0	14,8	14,7	14,7	14,7	14,5	14,5	14,5	14,8
	% of Turnover	20,5	20,0	20,5	20,4	20,8	21,2	20,9	20,6	20,4	20,5	20,6	20,9	21,6
SME's	% of Enterprises	99,9	99,9	99,9	99,9	99,9	99,9	99,9	99,9	99,9	99,9	99,9	99,9	99,9
	% of Persons Employed	81,6	81,8	81,3	80,8	82,0	81,7	81,1	80,8	80,8	80,5	80,3	79,9	79,8
	% of Turnover	65,4	64,7	64,1	62,7	62,5	63,6	61,9	59,9	58,9	58,9	59,3	59,9	60,7
Large Enterprises	% of Enterprises	0,1	0,1	0,1	0,1	0,1	0,1	0,1	0,1	0,1	0,1	0,1	0,1	0,1
	% of Persons Employed	18,4	18,2	18,7	19,2	18,0	18,3	18,9	19,2	19,2	19,5	19,7	20,1	20,2
	% of Turnover	34,6	35,3	35,9	37,3	37,5	36,4	38,1	40,1	41,1	41,1	40,7	40,1	39,3

Source: INE. Note: *In 2001 uninominal enterprises were excluded from the statistics.

High growth rates in the late 1990s were accompanied by increasing levels of concentration. While the share of small companies increased slightly between 1996 and 2000 (from 96,7% to 96,9%), their weight on turnover and employment decreased sharply during these years (from 46,8% to 36% and from 54,9% to 49,6%, respectively). In the same period, larger enterprises were responsible for larger shares of turnover – from 40,5% to 46,3% — and employment – from 25,3% to 29,1%. This concentration tendency

was also present in medium size companies. Despite their lower representation in the total number of enterprises, their share of output and employment increased.

In the years before the crisis, between 2004 and 2007, large enterprises' share on turnover and on employment continued to rise, both at the expense of micro enterprises. As expected, this process of concentration of turnover in larger companies accelerated during the years of economic recession. It peaked in 2012 when 0,1% of all companies corresponded to 41,1% of total turnover, well above the share of 2004, 34,6%. In the same year, the share of SMEs on total turnover was 58,9%, also well under the level of 2004, 65,4%. The largest impact in terms of turnover came from micro enterprises.

The evolution of employment during the crisis deserves attention. One could expect that smaller firms would be more sensitive to sharp changes in the cycle in terms of employment. However, in 2008, large companies were the first to reduce employment, as shown by the decline in their share of the total. After that, the reduction in employment was more pronounced in small companies than in the remaining categories, with a corresponding increase in the share of micro enterprises (mostly until 2013) and large companies. Despite their relative loss in terms of turnover (-2pp), micro enterprises' share in employment was greater in 2016 than in 2007 (+1pp).

In 2016 SMEs were responsible for a lower share of turnover than in any of the years before the crisis. Medium enterprises are the exception. The relatively lower number of enterprises and larger share of output suggests a process of concentration within that sector.

This brief analysis points to three preliminary conclusions, that should be reinterpreted considering the information on the distribution of profits and investment.

Firstly, the analysis of the overall business structure confirms its dual nature, already identified in previous chapters. On one side, there is a myriad of micro enterprises, accounting for 95%/96% of all firms and responsible for circa 50% of total employment but only 23% of total turnover. On the other side, we have a small number of large enterprises (0,1%), that generate 20% of the employment but between 40% and 45% of total turnover.

Secondly, economic growth in the 1990s seems to have given place to an increase in concentration levels that prevailed during the 2000s, suggesting that the concentration of surplus in larger corporations has increased both during and after the economic boom.

Thirdly, as predicted in Steindl's and Kalecki's theories, the levels of concentration increased during the financial crisis and following economic recession, due to higher financial fragility of smaller enterprises. However, it is interesting to note that the fall in these companies' share of turnover did not lead to a corresponding fall in their share of total employment.

8.4. Profits vs. investment – a problem of distribution

After discussing the concentration tendencies within the Portuguese economy, it is important to understand their impacts in terms of non-financial corporate profitability and investment. Let us bear in mind that the main intuition behind this analysis is that the process of concentration of capital leads to the appropriation, by larger companies and conglomerates, of a greater share of the total surplus in relation to investment.

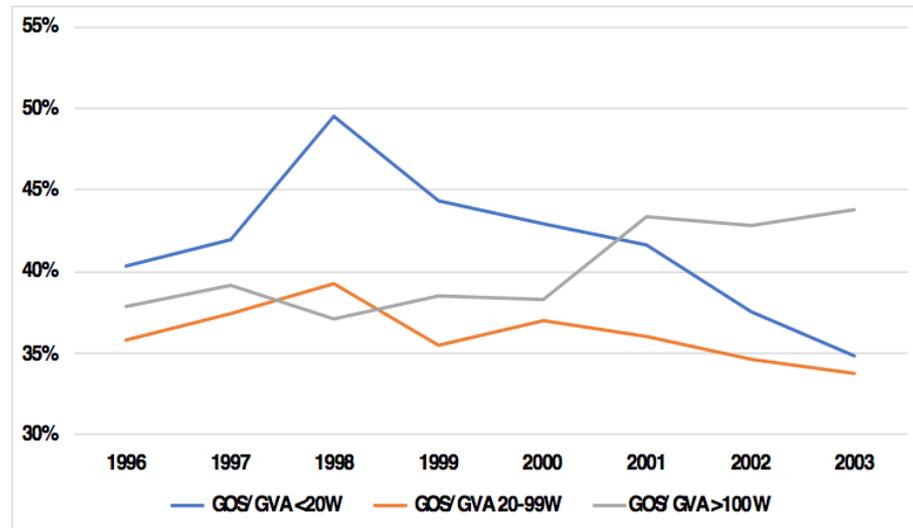
As mentioned above, measures of profitability require particular circumspection, since they often exclude financial motives, such as the impact of dividend distribution or debt payments, that affect differently different size companies. National Accounts have only recently started to address these issues. Hence, the standard measure that allows for longer term comparisons is still the gross operating surplus (GOS). To avoid long-term price effects, GOS is presented in relation to gross value added (GVA).

Measuring investment, usually through gross fixed capital formation (GFCF), is more straightforward than in the case of profits. However, before 2004 data of disaggregate investment per size of company presents several limitations, since it only exists for two of the categories (20-99 workers (W) and >100 workers (W)), and not for the total number of enterprises.

Figures 31 and 32 show the different GOS/GVA ratios, for different enterprise sizes, between 1996 and 2003, and 2003 and 2016, respectively. They disclose that the concentration wave during the economic growth of the late 1990s (already identified above) came about with a structural decline in the GOS/GVA ratio of smaller enterprises vis-à-vis larger companies. The profitability of smaller enterprises started dropping after the peak of 1998. That decline was particularly steeper during the *dotcom* crisis of 2002/2003. Larger firms, on the other hand, increased their ratio from the year 2000 onwards. In 2001, the GOS/GVA ratio of larger firms surpassed that of smaller enterprises, which continued to decline steeply.

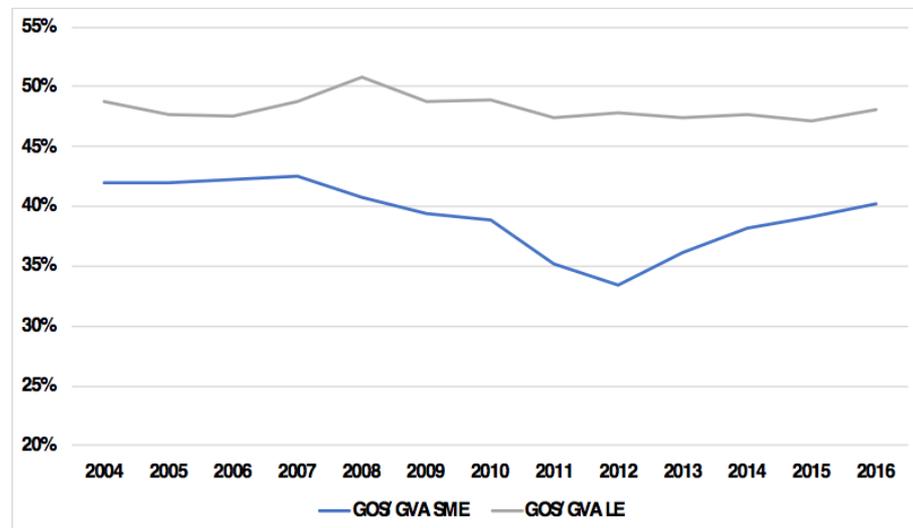
In the next period, large enterprises kept the relatively higher GOS/GVA ratio values, indicating larger profits. As expected, the stability of that ratio indicates greater resiliency of larger companies to economic recessions, contrary to SMEs, whose ratio fell by 9pp.

Figure 31 - Relation between GOS and GVA, 1996-2003



Source: INE.

Figure 32 - Relation between GOS and GVA, 2004-2016



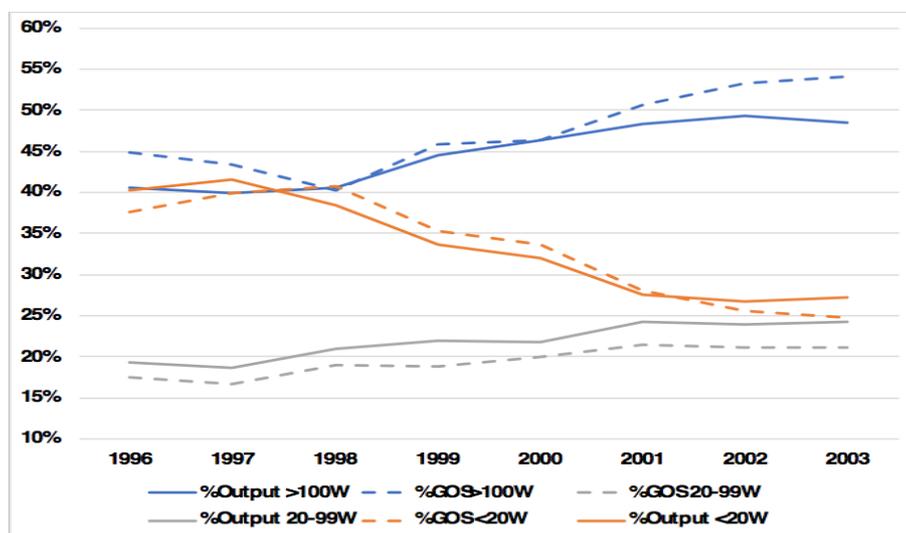
Source: INE.

One simple way of relating profits and production is to compare the share of GOS and of output associated for each enterprise size group, as presented in Figures 33 and 34. The proportions are not directly comparable between periods, since the definition of large

companies in Figure 34 is more restrict than in Figure 33. These differences explain why in the latter larger companies are associated to larger shares of output and GOS.

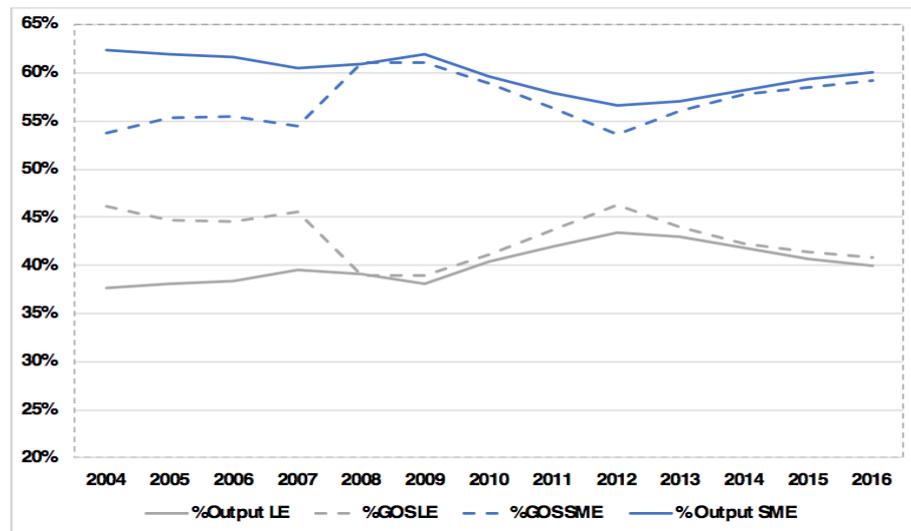
Nevertheless, there are important conclusions to be drawn from these graphs. First, with regards to larger companies, the proportion of GOS (dashed lines) is usually higher than output (solid line). This means that, regardless of the period under analysis, large companies appropriate greater shares of profits relatively to their contribution in terms of production. The only exception are companies with less than 20 workers, but only between 1998 and 2001. In the last years of the 1990s, the decline in the share of GOS and output of small companies (<20W), which was not compensated by a slight increase in the shares of medium enterprises (20-99W), led to an increase of 8pp and 10pp in the largest companies' shares of output and GOS, respectively. After the year 2000, output shares of larger and smaller companies seem to have stabilised, but GOS continued to raise/drop leading to greater positive/negative GOS/Output share gaps. Figure 34 shows how these gaps prevailed until the crisis of 2008: on average, between 2004 and 2007, large enterprises appropriated 45% of GOS but contributed to 38% of the production. Since the crisis, these gaps – that persisted during the 2000s - seem to have reduced.

Figure 33 - Share of output and GOS, 1996-2003



Source: INE.

Figure 34 - Share of output and GOS, 2004 - 2016



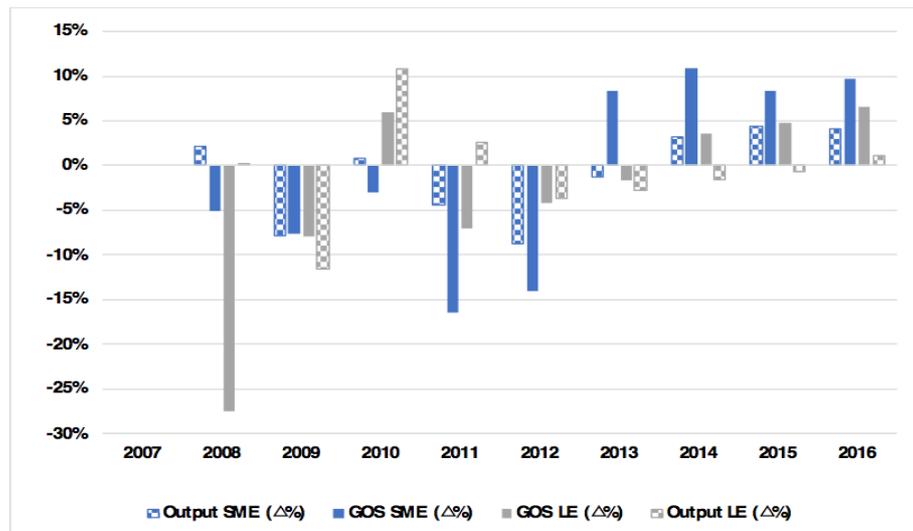
Source: INE.

In order to provide a better understanding of the behaviour of GOS and output in both groups of companies since the crisis, is necessary to take in consideration their variation rates, as shown in Figure 35.

In 2008, the first year of the crisis, large enterprises were the first to suspend production, as GOS dropped by 25%. However, after that first year, SMEs faced larger additional falls in GOS, mostly in 2010 and 2011. These different time lags in reacting to changes in the cycle from different type of companies explains why, in a first moment, the share of large enterprises' GOS declined relatively to SMEs.

After 2013, SMEs recovered in terms of profitability (GOS) and production. As GOS grew at a faster pace than output, the GOS/output gap remained small, but did not disappear or changed its signal (negative for SMEs and positive for LE). As for the large companies, their GOS grew at a faster speed since 2014, despite their negative or negligible contribution to output.

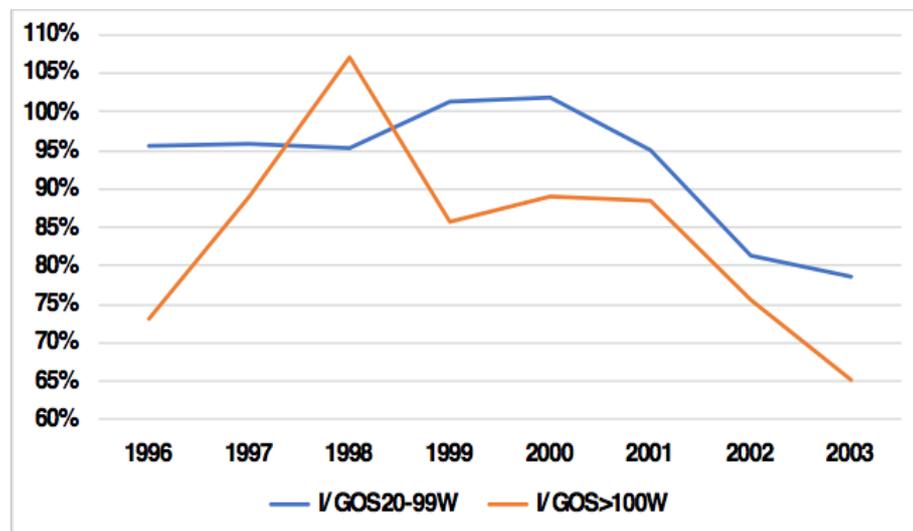
Figure 35 - Contributions to the variation of GOS and Output (%)



Source: INE.

Output's behaviour is only a proxy for companies' contribution to investment. Figures 36, 37 and 38 summarise the information available on investment (GFCF) by corporations' size category. It should be recalled that data on GFCF between 1996 and 2003 only includes companies with more than: 100 workers or between 20 and 99 workers. Two aspects stand out of Figure 36: except for 1998, larger companies invested a smaller part of their profit than their smaller counterparts; and in both cases, the share of GFCF on GOS declined sharply in the first years of the 2000s.

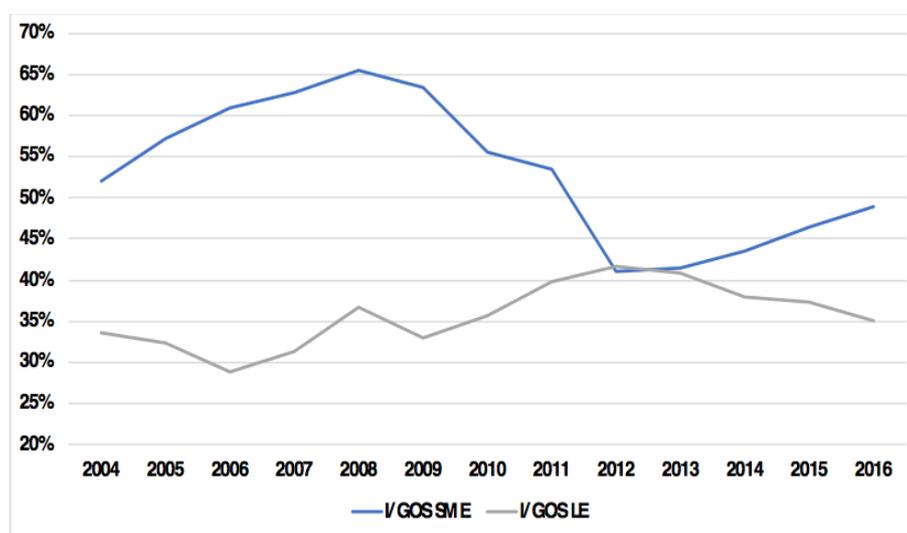
Figure 36 - Relation between GFCF and GOS, 1996 – 2003



Source: INE.

Figure 37 shows how, for large companies, this decline continued until 2006, with a small recovery in the following years. On the contrary, the I/GOS ratio of SME kept rising in those four years. In 2007, SMEs' share of investment on profits was 62,9%, twice the value for large corporations (31,4%). The sharp decline in the ratio for SMEs suggests that the relation between profits and investment is more elastic for SMEs than for large companies (whose ratio increased more due to the fall in GOS than to increases in GFCF). After the recession years of 2012 and 2013, both ratios moved in opposite directions, indicating that, structurally, SMEs tend to invest larger shares of their profits, and to respond more rapidly to changes in those profits.

Figure 37 - Relation between GFCF and GOS, 2004 - 2016

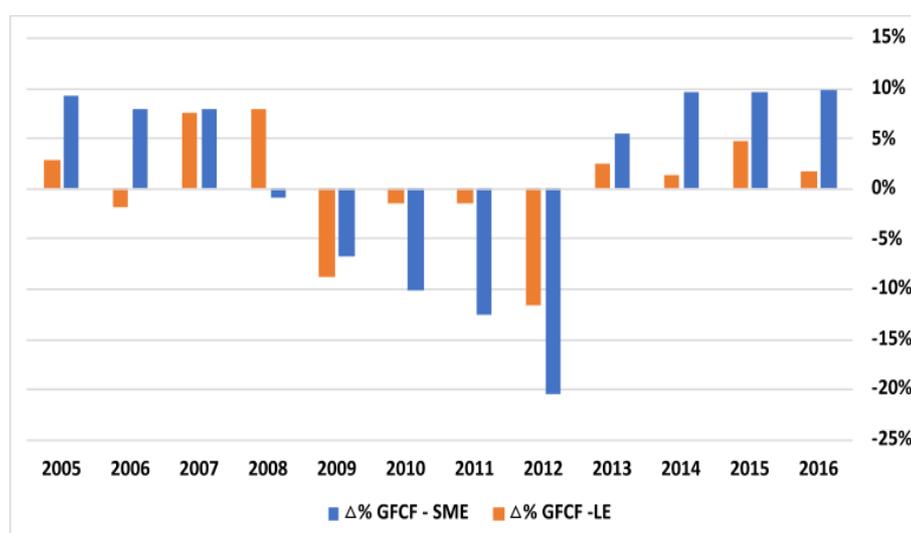


Source: INE. Relation between GFCF and GOS (2004 – 2016)

The importance and sensitiveness of SMEs' investment can be confirmed by breaking the annual change rates of total corporate GFCF into two components, as presented in Figure 38. This graph shows how variations in SMEs' investment decisions are decisive for the behaviour of total investment. This specific data series starts in 2004; therefore, the analysis in terms of change rates can only take in consideration the period between 2005 and 2016. The number of observations before the onset of the crisis is not enough to allow for conclusions on the structural characteristics of the contribution of SMEs and large enterprises to changes in total investment. Nevertheless, in 2005 and 2006, SMEs show a positive contribution to investment growth, while large companies' part was negative or insignificant. Large companies increased investment only in 2007.

As the crisis started, in 2008, SMEs were the first to reduce investment, while large companies sustained the growth levels of 2007. In the following years, and until 2012, SMEs were responsible for the largest part of the drop in GFCF. In the same way, between 2013 and 2016, the rise in the investment levels was mostly due to SMEs. On average, between 2013 and 2016, SMEs' GFCF grew at a rate of 8,7% while the change for large enterprises was 2,6%.

Figure 38 - Contribution to the variation of GFCF (%)



Source: INE.

In sum, the economic growth of the late 1990s increased the levels of concentration and led to a structural decline in SMEs' profitability (GOS/GVA) vis-à-vis large companies. This decline is also reflected in terms of GOS/output gaps, which persisted until the outbreak of the crisis. Simultaneously, the share of large enterprises's (>100 workers) fixed investment on GOS and, to a less extent, that of medium enterprises (20-99 workers) started to decline. In the case of large companies, that decline lasted until 2006. In contrast, the weight of investment on profit for SMEs was much larger and growing. The annual growth rate of GFCF also shows that SMEs had a large contribution to investment growth in 2005, 2006 and 2007.

The economic crisis which started in 2008 adds complexity to the analysis. Large companies were the first to face a sharp fall in profits and to reduce employment. After that first moment, they proved to be more resilient in terms of GOS/GVA ratio. The drop in investment and production during the recession, as well as the recovery afterwards,

was mainly due to SMEs, that proved to be more sensitive to variations in GOS. After 2013, SMEs recovered in terms of GOS growth rates, but also in production and investment. In contrast, large companies' growth in GOS came without investment or production.

8.5. Finance vs. investment – the principle of increasing risk

Banco de Portugal long-term series for Sector Tables provide useful additional information on corporations' annual balance sheets and financial ratios. Data on non-financial corporations can be disaggregated by size and economic activity and is provided by the Central Balance Sheet Database of *Banco de Portugal*, generated from data collected through the Annual Survey of the Central Balance Sheet Database (until 2005), and through IES – Simplified Corporate Information (from 2006 on).

This database has two advantages. It is constructed to allow comparability between indicators throughout time, as well as some level of disaggregation, based on economic activity (CAE-Rev3) and size of corporations ('micro', 'small', 'medium', 'large', as defined by the European Commission and in National Accounts). However, it also has several limitations. Values are only presented as annual averages for the required level of disaggregation, and sources of information and accounting standards vary according to distinct periods. The two most relevant changes occurred in 2006, when the CBSD Annual Survey (voluntary, 17.000 companies) was replaced by the IES (compulsory, around 350.000 companies), and in 2010, when the Official Chart of Accounts was replaced by the Accounting Standards System and the Accounting Standards for micro-entities. It should be noted that data for micro enterprises is only provided from 2006 onwards.

Sector Accounts do not provide a measure for investment, or gross fixed capital formation (GFCF), so, balance sheet tangible and intangible fixed assets (henceforth fixed assets) were used as a proxy. To simplify the analysis, data on micro (2006 on), small and medium enterprises was aggregated through the weighted average for every indicator, based on the sample number of enterprises. Data is presented in two size groups: SME (micro, small and medium enterprises) and LE (Large Enterprises).

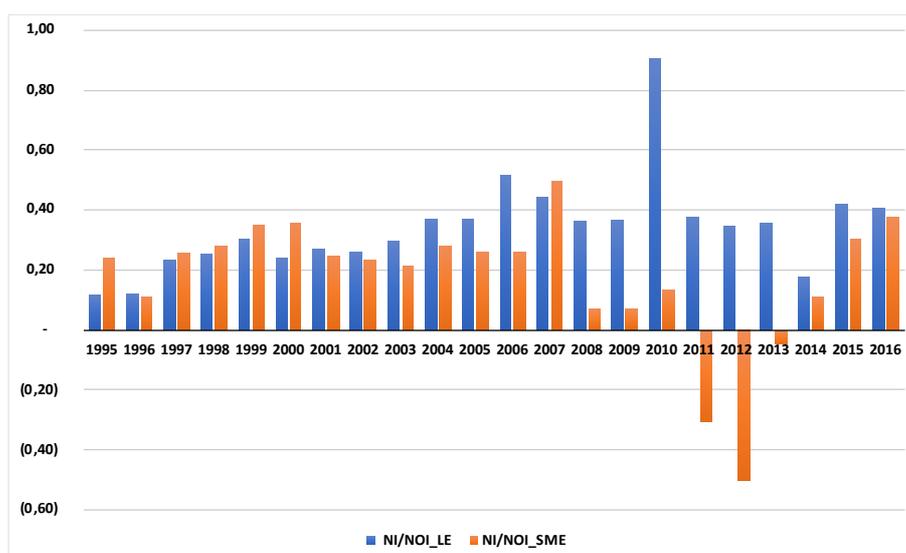
Considering that the GOS concept excludes gains not directly associated to production activity and is blind to distribution effects within corporations, average values of net

income provide an alternative measure of non-financial corporations' profits after taxes and financial payments. Figures 39 and 40 present two alternative analyses on the relation between overall profitability and production activity.

Figure 39 gives the average ratio of net income (NI) to operating net income (ONI). The latter concept is the balance sheet equivalent to GVA, since it measures income associated to the sale of goods and services related to the corporations' main activity. Hence, the ratio represents the fraction of total profits not originated in the production process, that can be related to tax or financial factors.

Between 1995 and 1999 this ratio grew for both groups of companies, although slightly more in SMEs. One possible explanation for this behaviour, to be confirmed next, is the effect of declining interest rates on financing costs, which was more beneficial to SMEs in relative terms. The impact of the *dotcom* crisis in the first years of the 2000s was first felt by large enterprises and lasted until 2002. However, from 2003 on, large enterprises' net income started to rise relatively to operating net income, suggesting that production lost importance as a source of profitability for these companies. On the contrary, for SMEs, the ratio stabilised around 20%. Throughout the crisis, larger enterprises managed to compensate the decline in net income, as shown by larger values of the NI/NOI ratios as compared to the pre-crisis levels. SMEs' ratio dropped to almost zero between 2008 and 2010, and below zero between 2011 and 2013, meaning that financial factors pushed profits down during this period.

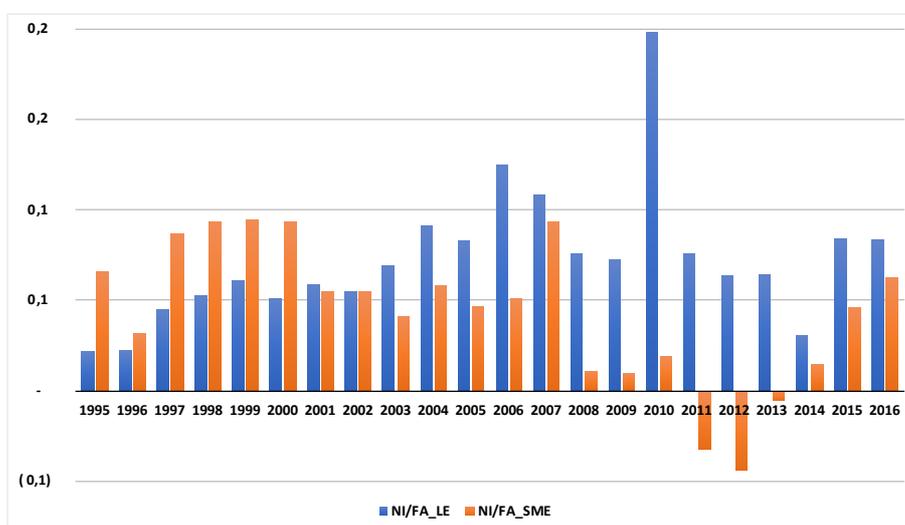
Figure 39 - Relation between Net Income and Net Operating Income, 1995 - 2016



Source: INE.

The ratio between net income (NI) and fixed assets (FA), presented in Figure 40, can be interpreted as a proxy for the relation between corporations' profitability and investment. There are three distinct periods: before the 2000s, SMEs' profits relative to fixed assets were growing and higher than those of large enterprises. During the 2000s, the situation inverted. Until the crisis, large enterprises' profits increased in relation to fixed assets, while SMEs' did not, and presented lower levels relative to the 1990s. During the crisis, large enterprises maintained the ratio between net income and fixed assets while, as expected, SMEs' profitability fell sharply.

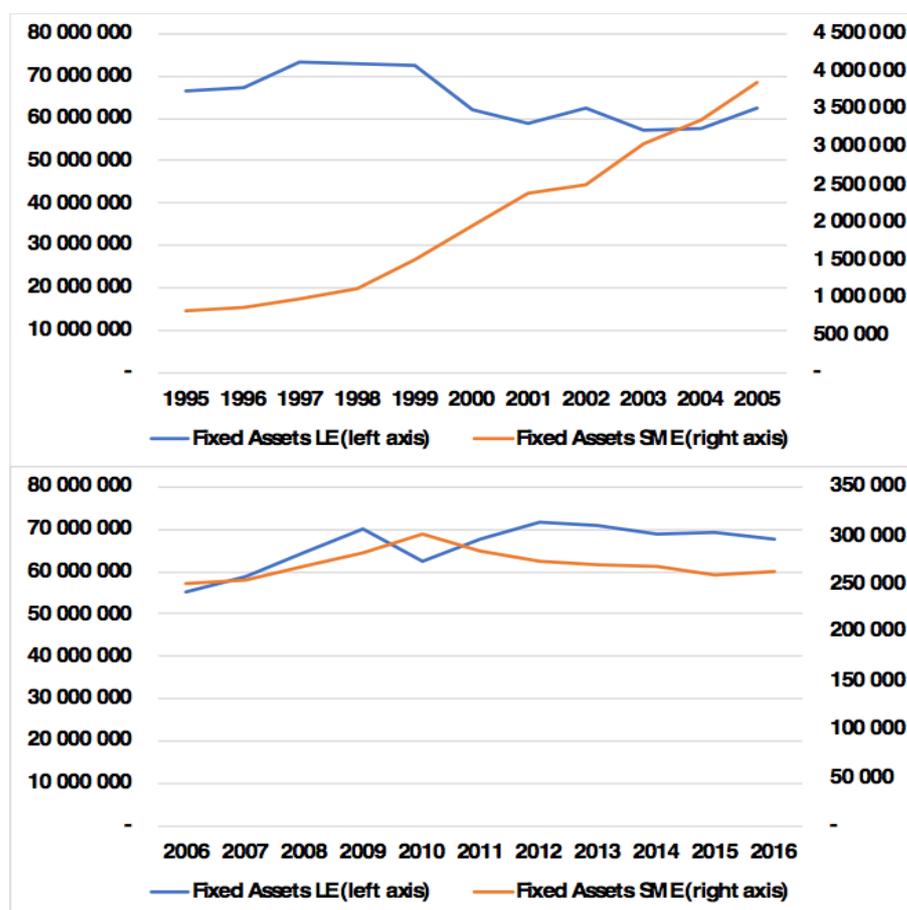
Figure 40 - Relation between Net Income and Fixed Assets, 1995 - 2016



Source: INE.

The NI/FA ratio can be better understood if the evolution of fixed assets is taken in consideration. Figure 41 presents the evolution of the average value of fixed assets for large enterprises and SMEs. The break in the series in 2006 renders the comparison between periods, presented below in two different graphs, impossible. Until the 2000s, the growth in NI/FA for SMEs happened as the value of average fixed assets per company increased. That tendency continued throughout the decade, despite the decrease in profitability. On the contrary, the growing proportion of profits relative to fixed assets for large companies was associated to decreasing – or stable – values for fixed assets. The second graph shows that, during the crisis, the impact on fixed assets was felt first on large enterprises, in 2010, and then mostly on SMEs, while large enterprises kept the value of fixed assets and fostered net income.

Figure 41 - Evolution of Fixed Assets, 1995 - 2016



Source: INE. Note: average values, thousand euros.

In sum, and taking into consideration the different characteristics and limitations of this database, an analysis based on *Banco de Portugal*' Sector Tables confirms and completes the overall conclusions from the National Accounts that large companies slowed down investment and increased profits (from other sources than production) during the 2000s, while SMEs kept stable profitability levels and invested more on fixed assets. During the crisis, the negative impact on SMEs' profitability caused investment to fall, while large enterprises proved to be more resistant in terms of net results.

There are multiple factors that may have contributed to this outcome. Literature points to the growing importance of finance as one of the key aspects that altered the functioning of mature capitalism economies in the last decades, namely in terms of the behaviour of large firms. The analysis in the previous chapter has also shown how the accumulation

regime that emerged in the 1990s implied the concentration of capital in rentist sectors, with monopoly profits and great prevalence of financial activities.

The reported differences between net income and net operating income for large corporations indicate that financial activities played indeed an important role during this period. This evidence should also be contextualised against the political and institutional backdrop of the time, marked by the process of financial liberalisation, as described already in previous sections.

The most systematic exercise to access the impact of different activities on corporations' returns is to breakdown the return on equity (ROE) — a proxy for shareholder return — in several parcels, as shown in Figure 42. This way, one can identify the specific value drivers of ROE's evolution associated to: i) operating activity, or operating effect, measured by the relation between net operating income (NOI) and the value of assets employed (A); ii) financing activities, or financing effect, measured by the compound leverage factor – the product between the leverage ratio, given by the proportion of assets covered by equity, and the interest burden, given by the relation between earnings before tax (EBT) and earnings before interest and tax (EBIT) —; and iii) the tax effect, given by the difference between net income (NI) and earnings before tax (EBT).

Figure 42 - The composition of Returns on Equity

ROE			
ROE = Net Income/Eq.			
Operating Effect	Financing Effect	Financial Activities Effect	Tax Effect
NOI/A	A/Eq. x EBT/EBIT	EBIT/NOI	Net Income/EBT

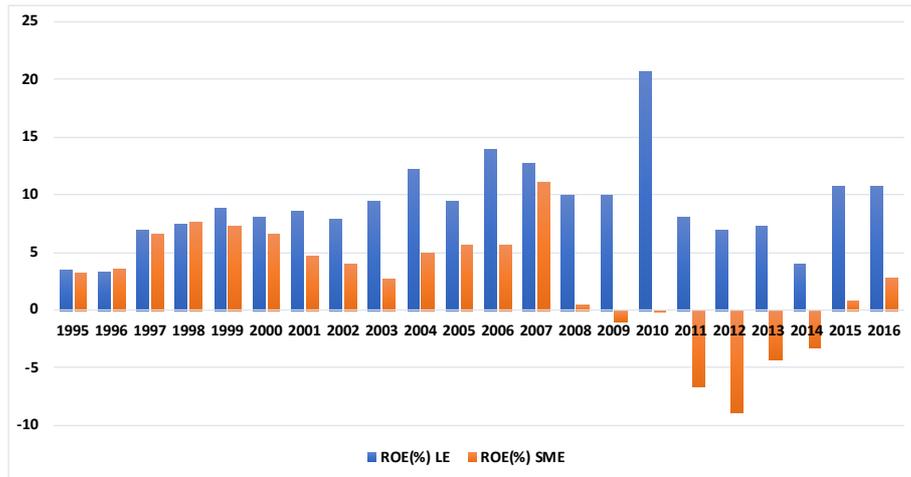
For a better understanding of the methodology proposed, let us recall the hierarchy of results in the profit and loss account:

Table 9 - Concepts of Profit and Loss Account

+	Economic Results	-
Production and other related income	Net Operating Income (NOI)	Intermediate Consumption, Employee Expenses and related expenditures
Income and gains from financial assets and liquid financial means	Earnings Before Interest, Taxes, Depreciation and Amortization (EBITDA)	Impairment losses, changes in fair value and other expenses and losses in financial investments and financial instruments
	Earnings Before Interest and Taxes (EBIT)	Expenses/reversals of depreciations and amortisations
Interest Income	Earnings Before Taxes (EBT)	Interest Expenses
	Net Income	Income Tax

Figure 43 shows that SMEs' average ROE has been declining, both in absolute terms and in relation to large enterprises, since 1999. Taking in consideration the exceptional nature of the year 2007, already mentioned, ROE during the 2000s never reached the levels registered in the last years of the 1990s. Large enterprises, on the other hand, kept on increasing the return on shareholders, not only during the 2000s, but also after the onset of the crisis. It should be noted that, while large enterprises seem to have recovered pre-crisis levels of ROE rather quickly after 2015, that was not the case with SMEs. The 'effects methodology' discussed above will allow for a better understanding of the motives behind the evolution of ROE.

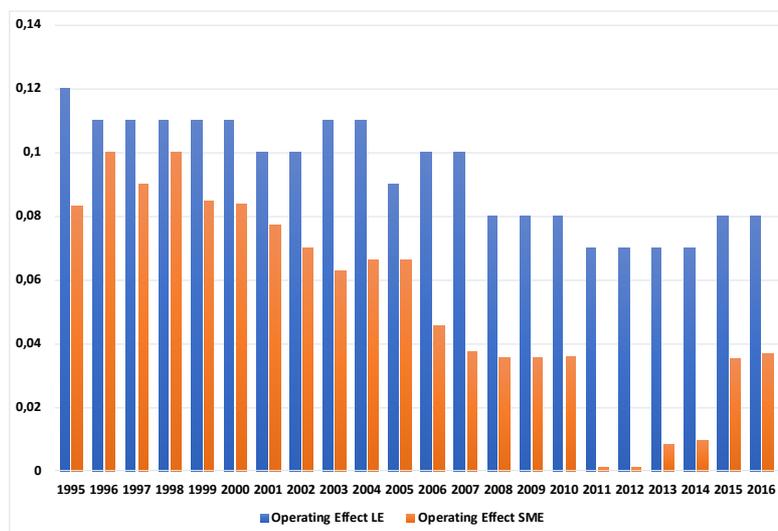
Figure 43 - Annual change in ROE (%), 1995 - 2016



Source: *Banco de Portugal*, Sector Tables.

The effect of operating activities on ROE is given by the operating effect, presented in Figure 44. Recall that this ratio relates the income directly imputed to production (NOI) to the average total assets of one company. During the 2000s, SMEs' increase in assets exceeded the growth in net operating income, causing the operating effect to decline. Large enterprises, on the other hand, managed to maintain operating effect levels, despite the stable or even decreasing net operating income. Before the crisis, the operating effect of large enterprises was twice that of SMEs, and that gap increased even further until 2014, when the contribution of NOI weighted by assets to equity returns dropped to zero.

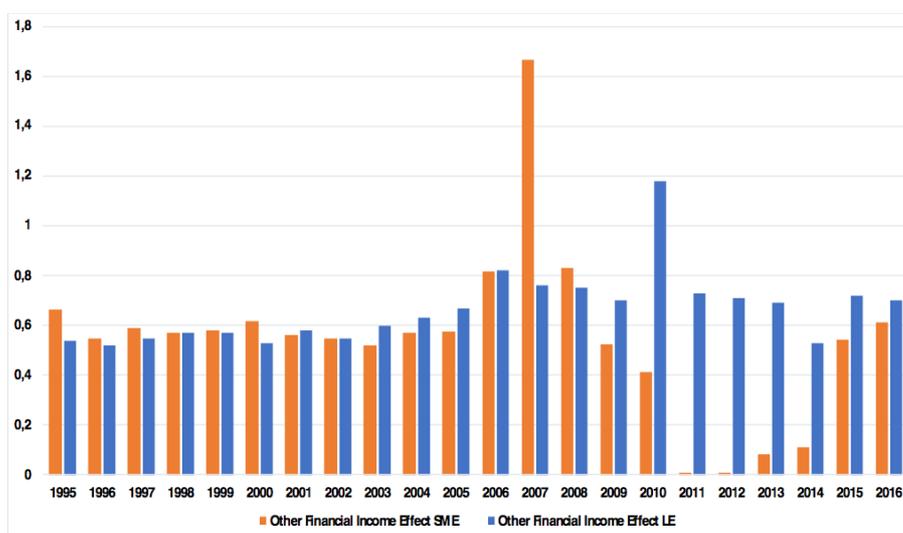
Figure 44 - Operating Effect, 1995 - 2016



Source: *Banco de Portugal*, Sector Tables.

Surprisingly, the effect of other financial income on returns (financial activities effect) did not make a difference for large enterprises relative to SMEs until the financial crisis (Figure 45). Except for the outlier in 2007, until 2008, the average level of this effect per company was approximately the same in both groups. After 2008, the situation changed, as income from financial activities compensated for the losses in large enterprises' operating income, while, for SMEs the effect was nil, contributing to an overall fall in returns.

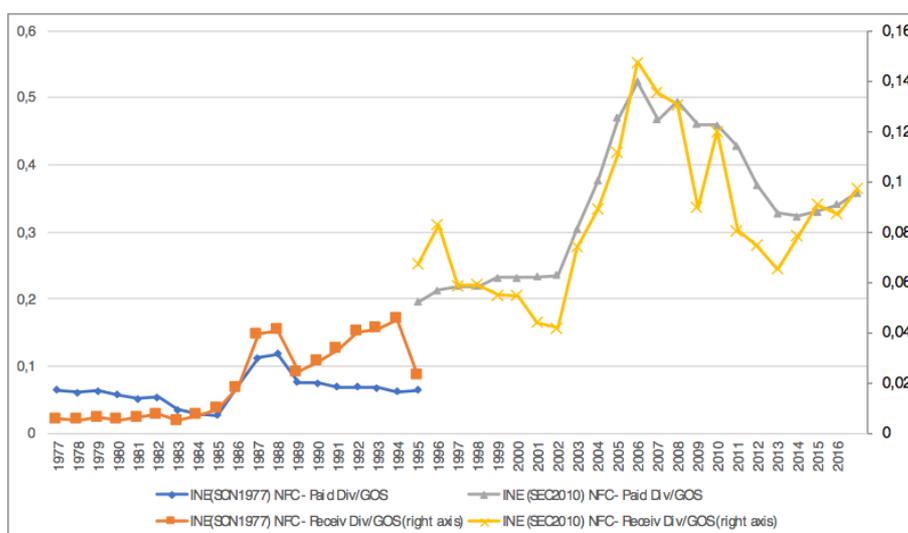
Figure 45 - Other Financial Income Effect, 1995 - 2016



Source: *Banco de Portugal*, Sector Tables.

This conclusion deserves closer attention. Data from National Accounts shows a sharp increase in the share of dividends on GOS for non-financial companies (Figure 46). Even considering the methodological discrepancies between series, the rise in that ratio is clear, particularly during the 2000s: from 20% in 1995 to a maximum of 52% in 2006 in the case of paid dividends, and from 7% in 1995 to 15% in 2006 for received dividends.

Figure 46 - Relation between dividends and GOS, 1977 - 2016



Source: INE, National Accounts.

Evidence therefore suggests that not only have financial payments gained importance in the economy as a whole over the past two decades, but that they have also consumed larger shares of non-financial profits from production. Notwithstanding, it appears that the level of detail of both the Table Sectors and the National Accounts does not allow for a clear understanding of the real distributional dynamics of dividend payments. Average values for enterprise hide that, within larger enterprises, some companies were mainly dividend payers – namely the privatised monopolies analysed in the previous chapter – while others were mainly dividend receivers – namely the financial groups or even groups of foreign shareholders.

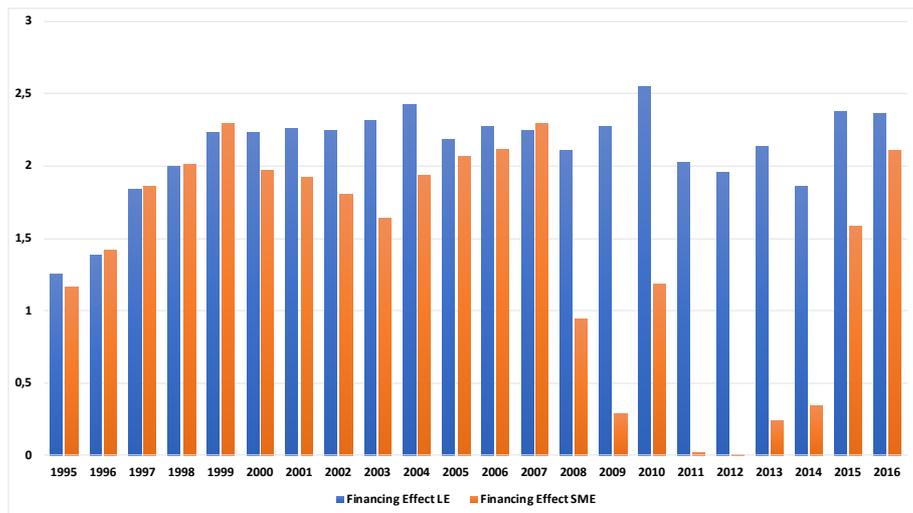
The most visible difference between different size group companies concerns the impact of the financing effect, shown in Figure 47. The interpretation of the compound leverage factor is rather complex and deserves attention. First, the graph shows that the leverage factor was the most relevant contributor to ROE, mostly until 1999 for both groups of companies, in the first half of the 2000s for large enterprises only.

It should be reminded that the financing effect, or compound leverage factor, has two components: the debt ratio (assets/equity) and the interest burden (payed interests/EBITDA). To understand the implications of the variations in the financing effect, it is necessary to take in consideration both these aspects individually. The case of SMEs offers a good illustration of this approach.

Between 1999 and 2003 the average ROE of SMEs dropped, as well as the operating effect and the financing effect. However, the decrease in the latter does not necessarily indicate that SMEs were becoming less leveraged. In fact, the debt ratios presented in Figure 48 show that SMEs were actually becoming more indebted, despite the fall in returns. The negative impact reflected in the compound leverage effect is due to the interest burden that started to increase in 1999, after a sharp decline in the years before. In fact, the tendency of SMEs during the whole period under analysis, and until 2012, was to increase the levels of indebtedness regardless of the decreasing ROE. High debt ratios made these companies extremely sensitive to variations in financing costs, as shown by the interest burden figures in Figure 49. In the year after the onset of the crisis, interest payments were already 40% of total EBITDA, which increased to more than 100% in 2012, meaning that interest payments consumed more than the earnings obtained from production.

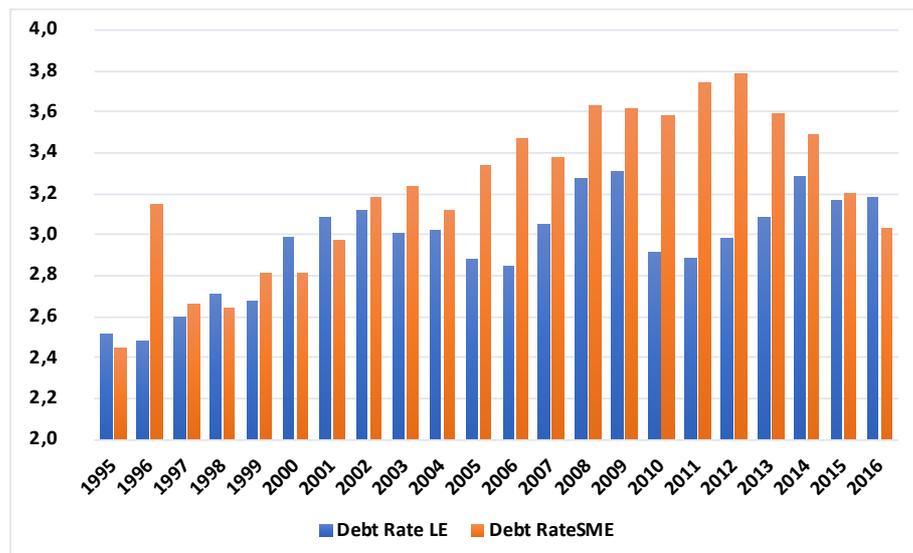
As with SMEs, large enterprises became more leveraged in the first years of the 2000s, as a response to the previous decline in the costs of financing. As with SMEs, during this period, debt grew faster than ROE; however, for large enterprises, the interest burden remained lower and growing at a slower pace than for SMEs. Due to the lower interest rate burden, large enterprises could keep higher values of the financing effect with relatively lower debt levels. This is not to say that large enterprises were not also becoming more indebted. Note that the debt burden in 2007, before the onset of the crisis, was higher than in 2002. The combination between momentary deleveraging between 2010 and 2012 and the maintenance of interest expenses under control kept positive levels for the financing effect during the crisis, contrary to SMEs. Nonetheless, such reduction in debt was short lived when compared to the deleveraging effect of SMEs, that took place later on but – so it seems – in a more structural manner.

Figure 47 - Financing Effects, 1995 - 2016



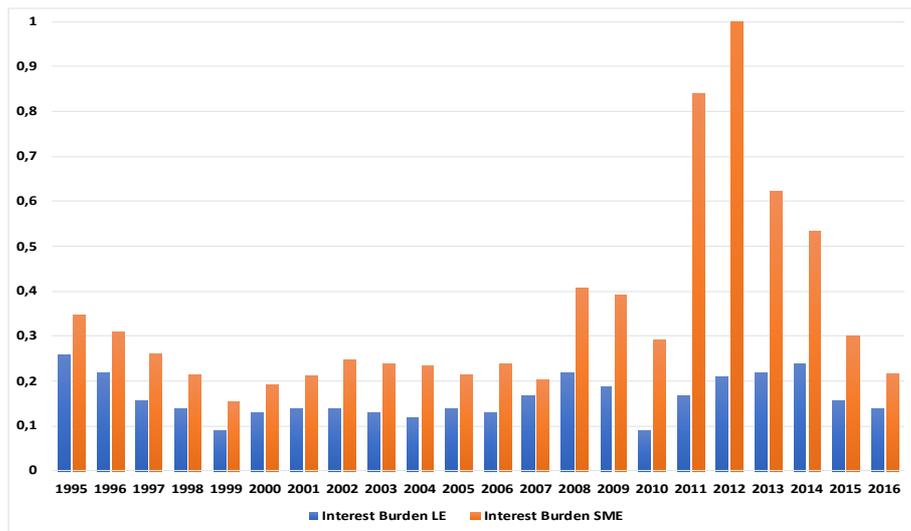
Source: *Banco de Portugal*, Sector Tables.

Figure 48 - Debt Rate, 1995 - 2016



Source: *Banco de Portugal*, Sector Tables.

Figure 49 - Interest Burden, 1995 - 2016

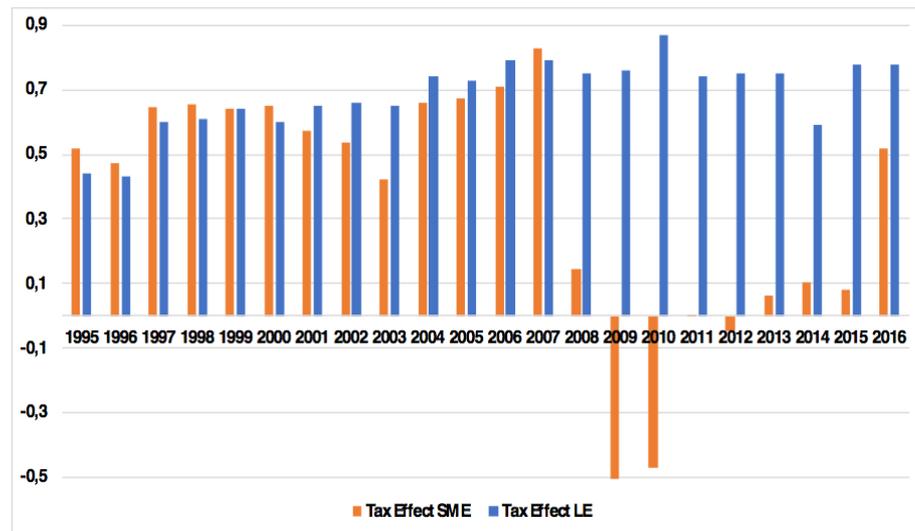


Source: *Banco de Portugal*, Sector Tables.

The last effect under analysis concerns the impact of income taxes on ROE. This is not an irrelevant aspect, since it measures the State's capacity to tax on an equal basis large and smaller enterprises, bearing in mind that the former, although more profitable, enjoy a scale advantage in tax planning strategies. On the other hand, the large majority of SMEs benefited, since 2001, from a special tax regime, with simplified rules and reduced tax rates, while the most profitable enterprises are subject to surtaxes on normal corporate tax rates. The tax effect is simply given by the proportion between net income and earnings before taxes (EBT); this being so, the larger the difference between both, the smaller the impact of taxes on profits. Hence, lower taxation levels have a direct positive impact on ROE.

Figure 50 shows that, after 1999, and except for 2007, the effect of corporate income taxes benefited large enterprises more than SMEs. The straightforward interpretation of these results is that, in general, large enterprises were more capable of minimising the impact of taxes on profitability. In other words, other things being equal, large enterprises were more capable of extracting profits from their activity than SMEs.

Figure 50 - Tax Effect, 1995 - 2016



Source: *Banco de Portugal*, Sector Tables.

Three conclusions stand out in the analysis just undertaken. First, investment efforts of SMEs occurred despite, and even at the expense of, returns, as shown by the overall evolution of ROE and operating effects. Secondly, these efforts, combined with lower profitability, occurred hand in hand with an increase in debt levels. As a consequence, the crisis left SMEs financially strangled, as interest payments consumed existing earnings. Large corporations, on the other hand, benefited from better financing conditions and were able to keep relatively lower debt ratios. However, that favourable context was mostly channelled to improve returns, and not to boost investment. Finally, contrary to what was expected, financial activities other than financing operations did not produce visible differences in terms of the impacts on returns before the crisis of 2008. After that, financial income benefited larger corporations.

8.6. Final remarks

This purpose of this chapter was to test, from a macroeconomic point of view, the main stagnation hypothesis developed throughout this dissertation: that this specific process of accumulation and concentration of capital – determined by the strategies of capitalists regarding their power and pecuniary interests – generated stagnant tendencies. These tendencies, emerged from the endogenous process of capitalist sabotage, materialised in the form of low growth and investment, indebtedness and financial fragility.

The process of capitalist sabotage explored in this chapter is a Veblenian interpretation of Kalecki's and Steindl's theories of investment and stagnation and refers to the concentration of surplus in large oligopolistic companies and its effects on investment and indebtedness. At the core of these theories lies a cumulative distributional problem, in the sense that those companies that are able to appropriate larger shares of profits and obtain better financing conditions invest relatively less, causing a downturn in the overall level of investments and future profits from production. At the root of large companies' low investment tendencies is a situation of excess capacity or, as developed by the Monopoly Capitalism school, the existence of more profitable alternatives, that can sustain profit levels despite the fall in production. The majority of small firms, on the other hand, faced investment constraints, due to the limited access to profits and the effects of the increased risk associated to debt financing.

The analysis in this chapter has shown that the theoretical approach summarised in the previous paragraph fits the data for Portugal and is capable of providing a convincing explanation for the stagnation tendencies that marked the Lost Decade and affected the economic recovery after the financial crisis of 2008. The results of this analysis are also consistent with the main conclusion from chapter 7 regarding the formation of a rentist capitalist class since late 1980s and 1990s.

Section 8.3 confirmed that the downward share of GFCF on GDP were associated to an increase in concentration levels – due to the liberalisation and privatisation processes in late 1990s – that remained in the 2000s. This rise in concentration levels accentuated what seems to be a structural characteristic of the Portuguese business structure, dominated by large enterprises that control a disproportionate share of the total turnover relative to their very small number or even share in employment. The immensely vast majority of firms are SMEs and, within that group, microenterprises. Their contribution to total employment is crucial (1/2), yet these companies control only around 1/5 of total turnover.

The increase in concentration levels towards the 2000s is associated to a general process of concentration and accumulation of profits in large enterprises that was not matched by a corresponding increase in investment or stock of fixed capital — quite the opposite.

This chapter's analysis revealed more than an overall increase in profits. In fact, it is reasonable to admit that the growth of profits was limited by the lack of total investment. However, the existing profits were being concentrated in the largest companies.

During the 2000s, and until the crisis, these companies' share of total profits was much larger than their share of output, confirming the hypothesis of a maldistribution of profits within the corporate sector. Furthermore, large companies invested a much smaller share of their profits in relation to SMEs, and that share declined since the late 1990s and until 2006. This evidence suggests that the complete lack of contribution of large companies to total investment found for 2005 and 2006 (disaggregated data started that year) might have been the norm in early 2000s, rather than the exception.

SMEs displayed opposite tendencies. Their contribution to output was generally larger than their share of profits, confirming the concentration of surplus on larger companies. Despite such unequal distribution of profits, SMEs continued to invest during the 2000s, consuming larger shares of their own internal funds (past profits). As a consequence, their stock of fixed assets increased relatively to income, as well as their indebtedness levels.

The increase in the debt rate of SMEs corresponded to heavier interest burdens. As suggested by Kalecki, the increasing risk undergoing in SMEs' balance sheets, as they replaced internal funds by debt, eventually came to impair their investment capacity, when the financial conditions changed. Large companies too became more indebted. However, the declining investment/profits ratio indicates that, in their case, debt was being channelled to other activities. Furthermore, due to their more favourable financing conditions, the interest burden did not appear to pose any constraint on investment. These findings are consistent with the behaviour of largest companies described in the previous chapter.

As expected, large companies were more capable of sustaining their profit levels during the crisis, which increased levels of concentration even further. This capacity is, as will be discussed below, associated, on the one hand, to monopolistic profits and, on the other, to their reliance on financial activities and low debt burdens. Nevertheless, the recovery in investment after the recession years was promoted, as before the crisis, by SMEs.

The increase in large companies' profitability is associated with different factors: better financing conditions, favourable tax effects and the combination of growing or stagnant operating income and a general decrease in fixed investment. The impact of financial payments and revenues is difficult to access, since its apparent stability may hide important distributional effects within the group of larger companies.

The analysis in chapter 7 brings some light into the findings just described. First of all, it suggests that large companies' profits had a rentist nature, as they were associated to activities promoted or protected by the State and with monopolistic characteristics. These institutional insights are also important to understand, on the one side, the lack of fixed investment by large companies and, on the other, the apparent neutral effect of financial flows, namely dividends, on these same companies.

Evidence suggests that, during the 2000s, Portuguese largest companies were involved mostly in financial operations and portfolio investment, with a focus on rentist sectors. This finding is consistent with Furman and Orzag's (2015) argument that rents favour an unequal distribution of income across firms, with a negative impact on growth.

As has been demonstrated, large non-financial privatised companies — those with greater investment potential — were more affected by dividend payments and share buybacks. In turn, the banking sector, where the propensity for fixed investment is much lower, was a large recipient of these funds. Given the small dimension of the Portuguese economy, the behaviour of these large conglomerates can explain both the low investment and the neutral dividend effect.

The other hypothesis, not explored in detail in this dissertation, is that part of the dividend and fixed investment flows were channelled abroad. In the first case, to remunerate foreign shareholders and, in the second, to expand groups' activities internationally, because of the excess capacity situation. This capital formation was not captured by National Accounts and may or may not appear in Sector Tables, depending on the corporate and legal structure of economic groups.

On the other hand, it should also be noted that – due to PPP projects – part of the fixed capital formation registered under the private sector was in, in reality, public. That aggregate impact is difficult to measure without knowing the concrete statistical methodology employed by INE. However, it is possible to obtain an approximation, by comparing the total value of investment involved in these projects with the sum of fixed investment by non-financial corporations. If one considers the period between 1999 and 2005, when these projects took place, the bias in the estimation of private investment is 12%.¹⁷⁶

¹⁷⁶ Total non-financial corporate investment between 1999 and 2005 was, according to *Pordata*, a Portuguese database, €120.801M, and the total amount of investment associated to PPP projects, as shown in Table, was €13.929M.

Overall, the empirical analysis in this chapter supports the stagnation hypothesis developed throughout this dissertation: the process of accumulation and concentration of capital in Portugal generated the stagnant tendencies behind the Lost Decade.

As has been argued, and demonstrated, stagnation is not a monetary problem that could be solved by some abstract manipulation of the natural interest rate. It is, mainly, a problem of distribution, originated by the forms of organisation and concentration of capital. In Portugal, the process of concentration of market power, addressed by Steindl's and Kalecki's stagnation theories, is associated to the consolidation of a rentist capitalist class. The accumulation of surplus in these large economic groups did not promote investment or the accumulation of fixed capital. On the contrary, it damaged those goals, by maintaining a malfunctioning economic structure where the theoretical link between profits and investment is reversed, as profits flow to companies not willing to invest, sabotaging the overall economic outcome.

9. Conclusions

The initial widespread optimism over a future of monetary integration at European level was short-lived. The turn of the tide was imposed by the financial crisis of 2008, which came at the end of a Lost Decade for the Portuguese economy, marked by economic stagnation and indebtedness. Deflationary austerity programmes extended the crisis into a recession throughout the first years of the 2010s.

The Great Depression motivated a profuseness of academic contributions trying to explain the root causes of the crisis. While most were focused on the short-term dynamics of recession and recovery, others have taken a long-term perspective, asking why economic growth has been so low in mature capitalist economies. These are (secular) stagnation studies.

This dissertation followed the debate on stagnation, as it sought to understand the structural causes behind the exceptionally disappointing macroeconomic performance of the Portuguese economy since the late 1990s.

In order to frame the problem at hand and come up with relevant research questions, chapter two reviewed and organised the different concurrent perspectives within the mainstream debate on stagnation. It identified and analysed two groups of stagnation theories – Wicksellian and supply side – to conclude that none of them could inform a

satisfactory framework for the chosen research topic. This conclusion was based on arguments of theoretical and methodological order.

The neoclassical structure underlying Wicksellian and supply side theories led them to one of two understandings of stagnation: it is either a monetary phenomenon, caused by a discrepancy between the natural and the observed interest rate; or an exogenously induced problem, caused by the unmanageable cycles of technology, or by poorly managed governmental action on markets.

Theoretically, these theories rely on a myriad of neoclassical abstract constructions — natural interest rates, efficient markets, constant returns to scale, factor productivity — that ignore the historical debates on the nature of money and capital. From a methodological point of view, these one fits all theories pretend to operate in a world of individual and national homogeneity, where history is described as neutral, and the system of classes is supposed to be surpassed, if ever existed at all.

Based on this analysis, it is only logical to conclude that mainstream theories of stagnation are not suited to address the complexity of stagnation as a historically determined phase of capitalism, nor the specificities of the Portuguese case.

Heterodox theories of stagnation, reviewed in chapter three, on the other hand, have dealt with most of these theoretical and methodological problems. More than that, they are the product of ideological and theoretical disputes with neoclassical economics throughout the history of economic thought.

The theories of Steindl and Kalecki are particularly relevant, as they present stagnation as a political economy problem: the outcome of the historical and social process of accumulation and concentration of capital, determined by the distributional effects of class and group conflicts. In short, these theories claim that market power allows larger firms to set higher markups and to operate in a situation of excess capacity that discourages new investments, causing stagnation.

However, while these theories provide the basic structure to look at the stagnation problem, they offer a narrow perspective of the process of concentration of capital – markups – and its consequences – excess capacity. To obtain a broader institutional and historical perspective on stagnation that could be applied to the study of the Portuguese economy, chapter four put forward an original reading of Steindl's and Kalecki's

theories through the institutional lenses of Veblen, with particular emphasis on his concepts of capital and sabotage.

To understand and discuss stagnation as the consequence of the processes of concentration and accumulation of capital, it was necessary to adopt a definition of capital which distinguishes capitalists' power and accumulated wealth from the production process and the stock of fixed assets. It was then established that the largest capitalists' strategies to accumulate and concentrate capital can damage the overall functioning of the productive system. This underlying idea of the detrimental effects of capitalists' action in pursuit of their own interests was explicitly developed by Veblen as sabotage but is also present in Kalecki's political business cycle or in the Marxist understanding of the contradictions of capitalism.

Once the theoretical premises were established and clarified, this dissertation addressed two research questions: i) *what were the specific strategies used by capitalists to promote the concentration and accumulation of capital in Portugal?* ii) *In what ways did those strategies contribute to low economic growth, low fixed investment and indebtedness?*

The empirical analysis developed in parts two and three of the present dissertation led to two general conclusions that require further development and discussion, in order to provide concrete answers to the research questions. The first is that the historical forms of capitalist accumulation and, in particular, the process of concentration of capital – from which market power is derived – are not strictly determined within the sphere of production and less so by the entrepreneurial skills of its beneficiaries. The second is that stagnation must be understood as the result of a specific regime of accumulation, in which the strategies of the capitalist class are contrary to investment and growth.

The visible hand of the State in the historical process of capital accumulation and concentration

Oligopoly – as the expression of concentrated market power – is in the very centre of Kaleckian and Steindlian theories of investment and stagnation. However, in Steindl's analysis, the formation of market power occurs within the competitive functioning of the production process.

In a recent article, Toporowski (2018) reveals a different and unnoticed contribution by Kalecki on this particular issue, made while commenting the life and death of Ivar Kreuger, a capitalist ‘hero’ of the interwar period, specialised in restructuring debts of troubled governments in exchange for monopolies on the matches market. The similarity with Count Burnay’s tobacco monopoly is not mere coincidence, as both were the outcome of the structure of the mechanisms governing the functioning of capitalism:

‘Kalecki was clear about Kreuger’s role in the evolution of capitalism, a progression that depended on *institutions* rather than the *individuals* who cast themselves as the heroes in the economic drama: “The functioning of capitalism depends not on the nature of individual foremen who control its mechanisms, but on the structure of those mechanisms [emphasis added].’ (Toporowski, 2018, p. 110)

The focus on the institutional character of the development and functioning of capitalism is also present in Sweezy and Magdoff’s (1987) historical analysis of the qualitative transformations of capitalist economies and the role of finance in operating these transformations towards an increasingly monopolistic system:

‘By the end of the nineteenth century, with the spread of larger and larger corporations ... the composition of the capitalist economy underwent a qualitative transformation. The issuance of many types and quantities of corporate securities brought in its train the development of organised stock and bond markets, brokerage houses, new forms of banking, and a community of what Veblen called captains of finance who soon rose to the top of the capitalist hierarchy of *wealth* and *power* [emphasis added].’ (Sweezy & Magdoff 1987, p.95)

Ever since, the continuous financialisation of capitalist economies motivated a vast group of post-Keynesian literature, focusing on the specific impacts of finance on the regime of capital accumulation. These studies, which intend to explain the transformations in the historical processes of accumulation and concentration of capital, are mostly derived from the experience of large Anglo-Saxon economies, with developed capital markets. For that reason, they tend to be ill-suited to the analysis of small bank-based economies and the specificities of their historical formation of oligopolies.

The analysis of the origins and historical evolution of the Portuguese main economic groups since the Nineteenth Century contributed to fill this gap. The current dissertation identified generic elements that, with different degrees of importance, collaborate in the formation of that capitalist hierarchy mentioned by Sweezy and Magdoff.

One of those elements is finance. It is well understood in credit theories of money that the real process behind the formation and thrive of a powerful capitalist class is quite remote from the classical fiction of the frugal craftsman saving his way into a large industrial corporation.

As pointed by Sweezy & Magdoff (1987) or Toporowski (2016a), but also previously by Hilferding (1910/2007) and Veblen (1904/2013), monopoly capital could only emerge through the workings of financial markets, where restructuring operations leveraged on debt allowed the concentration of ownership.

If money – as debt – is a precondition for large scale production, the concentration of ownership, as stressed by Veblen, is rarely motivated by the needs of the industrial process, or by the will to accumulate a larger stock of physical goods. What capitalists are looking for is, on the one side, concentration of ownership as such — as an institution of power — and, on the other, accumulation of financial wealth.

This understanding of the motivations driving capitalists' decisions brings some light into the theories of investment reviewed in chapter 3, the basis of heterodox theories of stagnation. The theoretical relation between the interest rate (considered as the cost of capital) and the level investment requires a pre-disposition for that investment. As noted by Kalecki, there are other, more important, factors determining investment decisions, related to capitalists' considerations about future profits and their position of power.

In this dissertation I argued, as Veblen did, that the strategies employed by capitalists to concentrate and accumulate capital may have a damaging effect on the overall investment. However, this is not to say, as it seems to be the case in the Monthly Review theories of stagnation, that the development of finance crucial to the processes of concentration and accumulation of capital, came the expense of industry or productive activities.

The analysis of the formation of the Portuguese capitalist class in the Nineteenth and Twentieth centuries suggests that the development of finance did not occur at the expense or as a consequence of the process of industrial development. The origins and expansion of large economic conglomerates lie far away from the industrial sector, which – apart from the second half of the period of dictatorship – occupied a subordinated position in the economy. Furthermore, the banking sector was always the centre of power. The capitalist system's organisation derived from it.

The source of such power is easy to understand. Direct control over the banking sector meant control over the process of creation and allocation of money, essential to any process of accumulation and concentration of capital. The historical importance of the banking sector in Portugal explains, in part, the concentrated nature of the capitalist ownership structure. In the second half of the dictatorship, this ownership was organised in the form of mixed conglomerates, where complex corporate structures served the purpose of transforming debt into equity within the same group. From the 1980s onwards, as capital markets developed out of the processes of deregulation and liberalisation, the more dispersed nature of formal ownership gave way to the creation of powerful capitalist networks, also organised around the banking sector.

The analysis of the historical importance of finance raises the question of why industry so frequently played a secondary role in the accumulation and concentration strategies of the Portuguese capitalists. That discussion leads to the second and perhaps most important element required to understand the concrete forms of the processes of capitalist accumulation and concentration – the State. It should be noted that, contrary to finance, the role of the State in organising capital formations has been absent from most post-Keynesian and post-Kaleckian literature (but not from Kalecki's writings).

This dissertation suggests that the State was a critical element, not only in the formation of large economic conglomerates, but also in directing their interests towards specific regimes of accumulation, namely through the creation of rents.

This conclusion can only be explored by crossing the frontiers of the literature reviewed in this dissertation, mostly focused on heterodox theories of finance and distribution. In Marxist and Post-Keynesian literature, the term rentist is often used to describe owners of property titles. This definition has many similarities with Veblenian's concept of waste or the Monthly Review's idea of wasteful activities, in the sense that it involves the appropriation of an income generated outside the production process. In Steindl's or Robinson's analyses of oligopolistic markets, rents refer, as in the neoclassical sense, to extra profits generated in non-competitive markets.

Although monopoly profits do exist, and constitute a form of rent, the comparison with a fictional alternative competitive market is an inadequate way to address this issue. Instead, in order to understand the role of institutionally created rents, and its relation to economic outcomes, one can benefit from looking at different perspectives.

The rent seeking approach put forward by Khan and Jomo (2000) to analyse the processes of economic development in Asia can be applied to understand the role of the State in the processes of concentration and accumulation of capital in Portugal.

Khan and Jomo define rents as incomes that are higher than what they would have been in a situation of no-rents. Generally, these rents – whether in the form of monopoly profits, direct transfers, or subsidies – are based on legal rights and institutions that are mostly determined by the State. Hence, in practise, through the creation and maintenance of rents, the State is capable of netting specific structures of incentives, with different economic outcomes.

This dissertation has shown how, whether in a fascist dictatorship or in a liberal democracy, the Portuguese capitalist class has always been the reflex of the structure of incentives or rents created by the State (under the influence of that same class).

The alignment of the interests of this powerful rent-seeking capitalist class with the overall goals of productive development and growth have depended on the existing incentives. During the second half of the dictatorship, high average rates of fixed investment were obtained through the artificial protection of monopoly rents in specific industrial sectors. However, it can also be argued that, in as much as promoting industrialisation, industrial conditioning policies contributed to the maintenance of inefficient productive structures and powerful economic conglomerates with a general sense of impunity.

During the late 1980s and 90s, a different regime emerged. ‘Almost all institutional change involves creating or destroying rents’ (Khan & Jomo, 2000, p.6) and the neoliberal programme, firmly encouraged by the newly created European institutions, gave way to a different set of rents — first and foremost, in the exploitation of privatised natural monopolies, but also in the financial and construction activities. These were the sectors where old and recent capitalists concentrated their expansion strategies. It is clear that, during this period, the dimension of economic conglomerates did not result in larger investment. It may have reinforced instead the state of dependence, on one hand, and power of influence, on the other, on the State’s industrial capacity.

There is one additional aspect that should be highlighted in these concluding remarks. Throughout the history of the Portuguese capitalist accumulation, fraud appears as a regular behaviour of large economic conglomerates, as a form of rent-seeking, to capture

rents, but not only. It has also been used as an instrument to overcome legal restrictions to expansion or to improve financing conditions.¹⁷⁷

In economic literature, the most studied type of illegal action is corruption, explored in the context of developing economies. Corruption is generally defined as the illegal practises connected to the allocation of certain public privileges and resources in response to bribes or other kinds of rewarding from private agents.¹⁷⁸ As a result, the focus has been, on the one side, on the role of incentive structures favouring corrupt behaviours (Rose-Ackerman, 1978) and, on the other, on the efficiency and costs of those activities (Khan, 1996, 1999; Nye, 1967).

The Portuguese case indicates that illegal activities have been a neglected but important part of the accumulation and concentration strategies of large conglomerates and businesses. This element was only superficially mentioned by Veblen. In his description of sabotage, there is a reference to a subtler reality, namely the action taken within the letter rather than the spirit of the law in order to secure vested interests.

Because there are scale economies in fraud, in the sense that these practises are enabled by the concentration of financial and political power, while also serving that same process of concentration and accumulation, this element should be taken in consideration in further debates on the historical process of accumulation and concentration of capital.

As noted by Whyte & Wiegratz (2016), that put forward an analysis of the moral culture of fraud in neoliberal capitalist societies, the prevalence of fraud is associated to economic costs – the loss of public resources, mis-channelling of funds and economic fragility – but also to political and social costs, associated to the legitimacy of democratic and justice systems.

In conclusion, the strategies of concentration and accumulation of capital in Portugal were, to a large extent, determined by the existing structure of incentives, and required a strategic access and use of the financial system. The accumulation of fixed capital through investment was neither an autonomous strategy nor a goal of the Portuguese capitalist class. Their aim was the concentration of power and accumulation of wealth which, under certain circumstances, came with a process of productive growth whilst in others brought stagnation.

¹⁷⁷ This analysis refers only to Portugal, but there is no intention to argue that fraud is not a structural element of capitalism elsewhere.

¹⁷⁸ See Heidenheimer, Johnston & LeVine (1997) and Bardhan (1997) for seminal works on corruption.

Stagnation: when the strategies become sabotage

Veblen's notion of sabotage was fairly straightforward, as it referred to the industrial inefficiencies that emerge as a consequence of individual strategies of capitalists - *i.e.*, property owners:

‘The ownership of the capital goods affords a discretionary power of misdirecting in the industrial process and perverting industrial efficiency, as well as inhibiting or curtailing industrial processes and their output, while the outcome may still be profitable to the owner of the capital goods.’ (Veblen, 1908b, p.108)

The specific cases of Cimpor and Portugal Telecom are compelling illustrations of sabotage in the Veblenian sense. In both cases, large profitable companies were dismantled by the action of their main shareholders, driven by particular pecuniary and power strategies. However, to explain stagnation, sabotage must be re-interpreted – as it was in this dissertation – in a broader sense. Sabotage is not the breaking of a moral code of conduct in capitalism. It exists whenever the strategies of capitalists contribute to produce a regime of accumulation that is contrary to the goals of economic growth and stability – a system prone to cyclical crisis and stagnation.

So that it can take place, capitalist accumulation requires the generation and appropriation of surplus. In theory, that surplus represents the basis of an economy's investment capacity. However, in practise, capitalism has no mechanism to guarantee that that surplus will be distributed and used in a growth enhancing way. In other words, capitalism has no mechanism to guarantee that that surplus will be invested productively.

Therefore, regardless of the technological conditions of production, it might be the case that the root cause of the problem is not the limited supply of (fixed) investment opportunities – as suggested by Hansen–, or its declining returns in relation to the cost of capital (interest rate) – as suggested by Keynes – but the existence of alternative investments that serve the strategic interests of those capitalists that appropriate larger shares of the surplus better.

The Portuguese Lost Decade is the outcome of an accumulation regime forged in the meeting of minds of a rentist capitalist class and a neoliberal State. The surplus generated by this regime was gradually appropriated by a share of large corporations and their

shareholders, who had no interest whatsoever in turning it into productive forms of investment, regardless of the declining long-term interest rate.

This conclusion incorporates different, yet related, empirical findings that support the main hypotheses in Kalecki and Steindl's theories of stagnation:

- i) High levels market power concentration, which increased in the late 1990s and during the Great Recession;
- ii) Maldistribution of profits towards the largest corporations with market power, operating in rentist sectors. In some of these sectors, the installed capacity was excessive in relation to the domestic market;
- iii) A majority of SMEs to which the principle of increasing risk applied, constraining investment and increasing indebtedness;
- iv) Long-term decline in investment, not chiefly determined by the interest rate (whether natural or real), but rather by the interaction of different factors related to distributive impacts of market power.

The liberalisation and privatisation programmes in late 1980s and 1990s brought about an increase in concentration levels which remained throughout the 2000s. That concentration was associated to a process of maldistribution of profits towards the largest companies. This bias is explained by a combination of different factors, namely, more favourable financing conditions, lower incidence of taxes on returns, and access to rents. However, as surplus was becoming more concentrated in larger corporations, a simultaneous process of maldistribution of investment was also taking place, in the opposite direction. In the sector of small and medium enterprises, an increase in investment activities relative to profits was accompanied by the accumulation of banking debt and, therefore, of financial risk.

Since this economic structure was not capable of balancing the generation and distribution of surplus with the generation and distribution of investment, the system responded with debt and financial fragility. And this is the reason why stagnation and indebtedness are such a good match.

In the words of Toporowski,

‘... corporations, monopolies, and cartels are parasitic upon a non-cartelised sector of small and medium-sized retail and industrial enterprises, farms, and so on. The profits from their individually modest investment accrue

disproportionately, through the functioning of the markets, to the corporations that dominate those markets. The losses of the smaller businesses have to be covered from their reserves or by borrowing. In this way their inconsiderable savings pass into the possession of those corporations, whose accumulations of liquid assets (bank deposits) are backed ultimately in bank balance sheets by the mounting debts of the smaller businesses.’ (2018, p.114)

Consumption and the declining labour share of surplus also play important roles in the story of the Portuguese stagnation. In every historical moment, the same policies that promoted the strategies of the capitalist class also served to weaken the power of workers, to control its aspirations and restrain the action of trade unions. That was the case during the fascist dictatorship, gaining the Captain’s support with the promise to discipline Republican ambitions of a burgeoning working class; as it was during the liberal European integration process that imposed new labour regulations, going back on what had been achieved in Revolutionary context. The other face of sabotage is inequality, labour precarity, long working hours and low wages — all of them structural features of the Portuguese economy.

The topic of this dissertation is the historical process of capitalist concentration and accumulation, focusing on the specific strategies of large capitalists. It should be noted, however, that this same process can be analysed from other angles, highlighting ongoing social struggles, and the role of trade unions, social movements and political parties in these class conflicts. The absence of this element of class conflict in the present dissertation is the consequence of an analytical choice and should not be interpreted as a lack of recognition of its importance.

Finally, this investigation can attempt to answer one final question: what discouraged investment in largest companies?

The findings that support this answer are based on the detailed analysis of the evolution and behaviour of the largest Portuguese companies in the 2000s. This type of methodology could never cover the complete universe of the existing companies, but still provides a valuable understanding of the predominant corporate dynamics in the top of the ‘capitalist hierarchy of wealth and power’ (Sweezy & Magdoff 1987, p.95).

This hierarchy developed around sectors with higher returns – due to rents or protected profits —, on the one hand, and political power, on the other. These sectors were, apart from natural monopolies in energy and communications, retail, construction and banking.

Most of the investment associated to plants and infrastructures owned by companies in the utilities sector took place before privatisation. Therefore, during the 2000s, these companies were mainly focused on creating shareholder value, in particular through the distribution of dividends. There is also evidence that the largest Portuguese corporations, especially the ones operating internally in monopolistic conditions, channelled an important share of their resources into foreign direct investment activities. This investment, which in reality took the form of international merger and acquisitions, was the response to the concentration of surplus in sectors where the installed capacity was large in relation to the domestic market.

A related topic that deserves further development is the observed change in the structure of the Portuguese ownership, namely from national to foreign powers.

Besides construction, the focus of the largest Portuguese economic groups was on two — very concentrated — non-manufacturing sectors: wholesale and retail and the banking sector. These are very different activities, despite sharing common characteristics: labour intensity (unskilled and low paid in the case of retail and the opposite in the case of banking) with limited investment possibilities, due their tertiary nature, but also because these companies operated in mature, consolidated markets. Furthermore, strategies for expansion were based on stock market operations, namely mergers and acquisitions, and in sectors with higher returns – due to rents or protected profits — and political power, completing the endemic rentist cycle.

Therefore, large companies were not only appropriating larger shares of surplus in relation to their investment activities, but also driving the economy towards sectors with low investment potential. The exception to the rule is in the construction sector, where most of the existing investment was concentrated.

If most of the investment was in construction, and if small and medium companies were the largest contributors to overall investment, then it is only tautologic to state that investment in construction also came mostly from smaller firms. It can always be argued that smaller firms were also involved in the promotion of this system of construction monoculture, and that is indeed correct. However, that fact does not interfere with the overall conclusions. In the first place, because the structure of incentives that promoted construction instead of other sectors was still determined by a combination of powerful political and economic interests; and in second place because that fact does not erase the other finding — the largest companies were not investing throughout the Lost Decade.

Quite remote from its original use, the notion of sabotage, eventually used to describe the resistance tactics of trade unions and organised workers, took the form of an investment strike promoted by strategies of large capitalists.

Under-investment, which is the root of secular stagnation, is not the outcome of a discrepancy between the observed interest rate and its *natural* counterpart. In part because that argument implies the assumption that such equilibrating variable does exist, but also because it has been shown that the interest rate is not the most important element in determining investment. Based on the very concrete case of the Portuguese economy, this dissertation tried to find other structural causes behind low investment levels. I came to the conclusion that under investment emerges out of the distributive impacts of the process of concentration and accumulation of capital. Therefore, although my methods were not entirely Kaleckian, my conclusion is.

10. References

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APPENDIX

Table Ap. 1 – *Planos de Fomento* [Development Plans]

	<i>Planos de Fomento</i>				
% of total	LRE (1935-1950)	I (1953-1958)	II (1959-1964)	Intermediate (1965-1967)	III (1968-1973)
Agriculture	30,7	17,4	17,3	8,2	13,5
Industry	1,3	11,9	27,5	43,1	25,2
Tourism and Services	-	-	-	4,2	9,7
Energy	1,5	35,3	21,4	17	14,6
Transports and Communications	36,4	32,8	30,8	18	23,8
Housing	30,1	-	-	5,4	6,6
Education and Health	-	2,2	3	3,5	6,5
Total (billion PTE, constant prices)	4,4	8	21	35	122
Total (%GFCF)	-	14,2	20,4	42,9	39,1
Total (% GDP)	<2	2,4	4,3	9,6	10,1
Financing					
Public Sector	100	51	23	30	29,7

Foreign Capital	-	10	23	n.a.	13,1
Public and Private Companies	-	39	54	n.a.	57,1

Source: Lains (2003, p.175). LRE: Lei de Reconstituição Económica.

Table Ap. 2 – Reorganisation of the nationalised banking sector

Banking Sector	
Previous	New
Banco de Portugal	Central and issuing bank
Banco de Angola	Disappears
Banco Nacional Ultramarino	Caixa Geral de Depósitos
Banco Pinto Magalhães	União de Bancos Portugueses
Banco de Angola	
Banco de Agricultura	
Banco Português do Atlântico	Banco Português do atlântico
Banco Fernandes Magalhães	
Banco do Algarve	
Banco FONSECAS & BURNAY	Banco FONSECAS & BURNAY
Banco do Alentejo	
Casa Bancária Pancada e Moraes	
Banco Espírito Santo e Comercial de Lisboa	Banco Espírito Santo e Comercial de Lisboa
Casa Bancária Mendes Godinho	
Banco Pinto & Sotto Mayor	Banco Pinto & Sotto Mayor
Banco Totta & Açores	Banco Totta & Açores
Crédito Predial Português	Crédito Predial Português
Sociedade Financeira Portuguesa	Sociedade Financeira Portuguesa
Insurance	
Previous	New

Mundial	Mundial Confiança
Confiança	
C ^a . Seguros Pátria	
Continental	
Tranquilidade	Tranquilidade
A Nacional	
Garantia	
Império	Império
Tagus	
Douro	
Alentejo	
União	Bonança
Ultramarina	
Comércio e Industria	

Source: Own elaboration based on Caeiro (2004), Pintado and Mendonça (1989), Costa et al (2010), Rosa (2014)

Table Ap. 3 – Reorganisation of the nationalised industrial sector

Industry		
Previous	New	Sector
SONAP	PETROGAL/GALP	Fuel
PETROSUL		
CIDLA		
SACOR		
CUF	QUIMIGAL	Chemical industries
Nitratos de Portugal		
Amoníaco Português		

C ^a . Portuguesa de Celuloses	PORTUCEL	Paper and pulp
SOCEL		
CELTEJO		
CELNORTE		
Celuloses do Guadiana		
Tabaqueira	Tabaqueira	Tobacco
INTAR		
C ^a . Portugusa de Electricidade	EDP	Electricity (production and distribution)
União Electrica Portuguesa		
CHENOP		
Hidroeléctricas		
C ^a . Eléctrica das Beiras		
CRGE		
CISUL	CIMPOR	Cemments
CINORTE		
Empresa de Cimentos de Leiria		
C ^a . De Cimentos do Tejo		
SAGRES		
CIBRA		
C ^a . Dos Carvões e Cimentos do Cabo Mondego		
CUFP	UNICER	Beer
COPEJA		
Imperial		
Sociedade de Cervejas	CENTRALCER	Beer

CERGAL		
others		
Telefones Lisboa e Porto	Portugal Telecom	Communications
Portugal telecom		
Marconi		
claras	Rodoviária Nacional	Road Transports
João Cândido Belo		
Empresas de Viação do Algarve		
Transul		
Eduardo Jorge		
António Magalhães		
Boa Viagem		
C ^a Nacional de Navegação		Naval transportation
Companhia de Transportes Marítimos		
SOPONATA		

Source: Own elaboration based on Caeiro (2004), Pintado and Mendonça (1989), Costa et al (2012), Rosa (2014).

Table Ap. 4 – Largest banks in 1994

Name	Major Shareholders
Caixa Geral de Depósitos (CGD)	State (100,0%)
Banco Português do Atlântico (BPA)	State (24,4%) Sonae BCP
Banco Totta & Açores (BTA)	Banesto / Champalimaud (50%) State (13%)
Grupo Espírito Santo (GES)	Esírito Santo Family
Banco Comercial Português (BCP)	Disperse
Banco de Fomento Exterior (BFE)	State (80,5%)

Banco Português de Investimento (BPI)	La Caixa Allianz Itaú Amorim
Banco Comércio e Indústria (BCI)	State (75,0%)

Source: Own elaboration based on D&B Informa, Grandes Grupos Económicos em Portugal, 1994, the Privatizations Barometer and Annual Accounts.

Table Ap. 5 – Largest non-banking corporations in 1994

Name	Activity	Major Shareholders
Petrogal	Oil Production/Refinery/Distribution	State (75,0%) Petrocontrol
Comunicações Nacionais	Telecommunications	State (100,0%)
SONAE	Retail/Real estate/Construction/Tourism	Azevedo family (Efanor)
Jerónimo Martins	Food distribution/Specialised retail	Jerónimo Martins Family
Entrepasto	Vehicles Wholesaler/Agriculture/Industry/Real Estate	Dias da Cunha family
Tabaqueira	Tobacco	State (100,0%)
José de Mello	Banking/Insurance/Health Care/Oil products	José de Mello
Pão de Açúcar	Brazilian Group in food distribution/Specialised retail	Abilio Diniz
Cimpor	Cement	State (80,0%)
Salvador Caetano	Vehicles Wholesaler/Construction	Salvador Caetano family
Portucel	Cellulose/Paper	State (100,0%)
Soares da Costa	Construction/Public works/Real estate	Soares da costa family
Teixeira Duarte	Construction/Public works/Real estate	Teixeira Duarte family
Interfina	n.a.	n.a.
Amorim	Cork production and distribution/Tourism/Real Estate	Amorim family

Source: Own elaboration based on D&B Informa, Grandes Grupos Económicos em Portugal, 1994 and Privatizations Barometer.

Table Ap. 6 – Largest banks in 2000

Name	Major Shareholders
Banco Português de Investimento (BPI)	Itaú (15%); La Caixa (14,7%); Grupo Allianz (8,8%); SONAE (4.3%); Grupo Arsopi (2.9%); Grupo Violas (2.9%); Caixa Geral de Depósitos (2,7%)
Caixa Geral Depósitos (CGD)	State (100,0%)
BCP Atlântico*	Caixa Geral de Depósitos (8,43%); Banca Intesa (7,43%); Eureka (6,92%); Amro Bank Amsterdam (4,99%); José de Mello (4,58%); EDP (4,36%) Bank Sabadell (3,12%)
Banco Espírito Santo (BES)	Espírito Santo Family
Santander Totta	Santusa Holding SL (99.848%) owned by Banco Santander Central Hispano S.A (100%)
Banif	Horácio Roque (Rentipar)
Finibanco	Costa Leite Family

Source: Based on D&B Informa, Grandes Grupos Económicos em Portugal, 2000 and Privatizations Barometer. Note: * Shareholder structure for BCP/Atlantico refers to 2002.

Table Ap. 7 – Largest non-banking corporations in 2000

2000		
Name	Activity	Major Shareholders
SONAE	Retail/Real estate/Construction/Tourism/Communications/etc.	Azevedo Family
Petrogal	Fuel Production/Refinery/Distribution	State (37,7%); ENI; Iberdrola; EDP
Portugal Telecom	Telecommunications	State (11,3%); Espírito Santo Group (9,57%); Telefónica (4,81%); CGD (4,72%); Brandes (4,39%); BPI (2,94%)
Jerónimo Martins	Food distribution/Specialised retail	Jerónimo Martins family

EDP	Electricity Production/Electricity Distribution	State (50,5%); BCP (5%); CGD (4,75%); Iberdrola (4%)
Siemens	Energy/Engineering/Components	Foreign
TAP	Airlines	State (100,0%)
Shell	Fuel and Lubricants	Foreign
Auchan	Food distribution/Specialised retail	Foreign
Amorim	Cork production and distribution/Tourism/Real Estate	Amorim family
SAG	Vehicle import/Automobile retail/Financial activities	Pereira Coutinho family
Portucel	Cellulose/Paper	State (55,7%); Sonae; Semapa
Teixeira Duarte	Construction/Public works/Real estate	Teixeira Duarte family
INAPA	Paper Distribution / Publisher	State; BCP
Renault	Automobile Trading/Parts production and sale	Foreign

Source: Own elaboration, based on Annual Accounts, D&B Informa, Grandes Grupos Económicos em Portugal, 2000 and Privatizations Barometer

Table Ap. 8 – Largest banks in 2007

Name	Major Shareholders
Caixa Geral de Depósitos S.A.	State (100%)
Banco Comercial Português	BPI (7,482%), Grupo Eureko (7,072%), Joe Berardo (5,246%); Grupo Teixeira Duarte (6,683%); Sonangol (4,984%); Banco Sabadel (4,434%); EDP (3,231%)
BES S.A.	BESPAR (Espírito Santo family and Crédit Agricole - 40%), Crédit Agricole (10,81%); Bradport SGPS (Bradesco – 3,05%); Previsão Seguros (Portugal Telecom – 2,62%); Hermes Pensions (2,03%)
Santander Totta SGPS, S.A.	99.848% Santusa Holding SL (100% Banco Santander Central Hispano S.A)
Banco BPI S.A.	La Caixa (25%), Itaú (18,3%), BCP (10%), Allianz (8,8%)
Banif SGPS	Rentipar SGPS (Horácio Roque)

Source: Own elaboration based on Annual Accounts, D&B Informa, Grandes Grupos Económicos em Portugal, 1998 and Privatizations Barometer.

Table Ap. 9 – Largest non-banking corporations in 2007

Name	Activity	State-Owned
SONAE SGPS	Retail, Malls, Communications	Efanor Investimentos - Belmiro de Azevedo family (52,9%); BPI (8,90%)
TAP - Transportes Aéreos Portugueses, SGPS	Airlines	State (100%)
Galp Energia SGPS	Fuel and Gas	ENI (33,34%), Amorim (33,34%) State (8%)
EDP SGPS	Electricity	State (20,49%); Iberdrola (9,5%); CajAstur (5,53%); CGD (5,25%); José de Mello SGPS (4,98%); BCP (3,4%); Pictet Asset Management (2,86%); Espírito Santo Group (2,32%); Sonatrach (2,23%)
Portugal Telecom SGPS	Communications	Brandes Investment Partners (9,65%); Telefónica (9,16%); Espírito Santo Group (8,90%); CGD (6,37%); Ongoing Strategy Investments (5,89%); State (5,11%)
Jerónimo Martins SGPS	Retail and Wholesale	Soc. Francisco Manuel dos Santos (55,9%); Astek S.A. (10%)
CIMPOR - Cimentos de Portugal SGPS	Cement Production and Retail	Teixeira Duarte SGPS (20,53%); Manuel Fino SGPS (20,26%); Grupo Lafarge (17,26%); Banco Comercial Português (10,04%)
Repsol Portuguesa S.A.	Fuel	Branch of Repsol Group
Semapa - SGPS	Cement, Pulp and Paper	CIMO SGPS – 12,1% (Pedro Queiroz Pereira) Longapar – SGPS – 16,9% (Pedro Queiroz Pereira); Sodim GGSP (Pedro Queiroz Pereira, Espírito Santo) – 19,75%; BPI Pension Fund (8,76%); BES Pension Fund (5,23%); Credit Suisse Group (19,94%).
Mota Engil SGPS	Construction, Public Works, Concessions	Mota family
Grupo Salvador Caetano SGPS, S.A.	Car Retail	Salvador Caetano Family
Auchan - Companhia Portuguesa de Hipermercados	Retail	Foreign
INAPA - Investimentos, Participações e Gestão	Paper Retail	State (32,72%) BCP (18,26%)

José de Mello - Sociedade Gestora de Participações Sociais	Management of Financial Participations, Helathcare, Real Estate, Energy, Chemical Products, Infrastructure	José de Mello
CTT - Correios de Portugal S.A.	Postal Services	State (100%)
Amorim - Investimentos e Participações, SGPS	Management of financial participations, Cork	Interfamilia II SGPS SA – 100% (Amorim Family - 100%)

Source: Based on Annual Accounts, D&B Informa, Grandes Grupos Económicos em Portugal, 2007 and Privatizations Barometer. Note: Total turnover for Amorim SGPS was not available.

Figure Ap. 1 - Galp stock prices, 2006-2008



Source: GALP

Table Ap. 10 – Galp’s financial data, 2000-2008

Indicators (million EUR)	2000	2001	2002	2003	2004	2005	2006	2007	2008
Net Assets	n.a.	5 760,0	5 926,0	6 069,0	6 123,5	5 934,0	5 242,0 ²	5 750,0	6 623,0
Equity	n.a.	1 440,0	1 490,0	1 675,0	1 914,0	2 036,7	2 361,2	2 370,0	2 218,8
Net Debt ¹	1 927,2	2 125,1	2 130,1	1 930,0	1 497,0	1 192,0	887,0	734,0	1 864,0
Net Debt/ (Net Debt + Equity)	n.a.	0,6	0,6	0,5	0,4	0,4	0,3	0,2	0,5
EBITDA	593,9	508,5	533,0	649,2	831,7	1 192,0	1 241,0	1 213,0	449,0
Debt/EBITDA	3,2x	4,2x	4,0x	3,2x	1,7x	1x	0,7x	0,6x	4,2x
Solvency Ratio (Equity/Net Assets)	0,2	0,3	0,3	0,3	0,3	0,3	0,5	0,4	0,3
Financial Investments (gross)	n.a.	n.a.	72,0	52,1	52,6	54,1	1,2 ³	1,3	1,4
Investment	n.a.	n.a.		466,3	335,0	315,0	349,0	466,0	1 560,0 ⁵
Financial Results	(75,7)	(70,1)	(56,6)	(20,9)	(29,8)	(30,9)	(6,6)	38,3 ⁴	(12,6)
Net Income	45,2	96,9	114,5	247,4	333,1	701,0	755,0	720,0	117,0 ⁶
Dividend per share	0	0,23	0,26	0,11	0,2	0,27	1,35	0,32	0,32
Total Dividend	n.a.	n.a.	n.a.	91	166	224	1123	252	265
Payout Ratio (Total Dividends/Net Income)	n.a.	n.a.	n.a.	36,8%	49,8%	32,0%	148,7%	35,0%	226,5%

Share Price (annual $\Delta\%$)	n.a	n.a	n.a	n.a	n.a	n.a	15,9%	187,4%	-57,8%
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Total Dividends (2003-2008)										Total
ENI				30,3394	55,3444	74,6816	374,4082	84,0168	88,351	707,1
Portuguese State				27,3091	49,8166	67,2224	78,61	17,64	18,55	259,1
REN				16,653	30,378	40,992	-	-	-	88,0
EDP				12,9857	23,6882	31,9648	-	-	-	68,6
Iberdrola				3,64	6,64	8,96	44,92	10,08	-	74,2
Setgás				0,0364	0,0664	0,0896	-	-	-	0,2
Portgás				0,0364	0,0664	0,0896	-	-	-	0,2
Amorim Energia				-	-	-	374,4082	84,0168	88,351	546,8
Caixa Geral de Depósitos				-	-	-	11,23	2,52	2,65	16,4
BPI				-	-	-	23,246	12,827	-	36,07
Caixa Galicia				-	-	-	22,46	-	-	22,5

Source: Annual Accounts. Notes: ¹Values for 2000, 2001 and 2002 are average values; ² The reduction in net assets results from the split between the oil and gas activities, with the selling of assets related to the area of regulated gas to REN and the transfer of 425,2 millions of associated debt; ³The reduction in the value of financial participations is explained by the selling of ONI (telecommunications company) to EDP. In that same year EDP sold the company to Riverside Company and Gestimin (Manuel Champalimaud, son of António Champalimaud). It is also explained by the consolidation of Companhia Logística de Hidrocarburos CLH, S.A.. ⁴Mostly explained by gains with financial participations. ⁵Investments were concentrated in oil refining and distribution activities. The increase in investment is justified with the acquisition of AGIP and Exxon Mobil in Spain for €752M and the first phase of a large reconvention operation of the Sines refinery. ⁶In 2008 the results were influenced by sharp variations in the international crude prices, causing losses not related to the operation but to the valuation of stocks (stock effect). Alternatively, GALP argued that, using the method of Replacement Cost, results have increased in 2008.

Table Ap. 11 – Portugal Telecom’s financial data, 1995 - 2000

Indicators (million EUR)	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Turnover	2 178	2 420	2 741	2 990	3 283	5 195	5 778	5 582	5 776	5 967	6 385	6 343	6 148	6 734	6 785	3 742
Net Assets	4 193	4 355	4 990	9 277	8 518	13 216	17 636	13 726	13 558	13 928	16 643	14 171	13 122	13 713	14 831	15 170
Equity	1 858	2 042	2 019	2 165	2 759	4 362	4 667	3 111	2 941	2 254	2 582	3 106	2 082	1 200	2 385	4 609
Net Debt	1 203	940	949	3 641 ¹	2 792	3 732	5 456 ²	4 037	3 216	3 573	3 673 ³	3 757	4 382 ⁴	5 571 ⁵	5 528	2 100
Short-term Debt	280	213	73 183	3 891	387	1 389	1 219	1 094	1 191	1 622	2 416	1 373	1 256	2 255	495	952
Medium/Long-term Debt	952	6 079	959 010	1 017	2 650	2 815	5 428	5 074	4 556	3 899	5 169	5 169	4 960	4 441	6 552	6 254
Net Interest	125	100	60	65					203	205	258	227	197	272	302	185
EBITDA	1 081	1 193	1 269	1 383	1 494	1 886	2 124	2 230	2 268	2 363	2 496	2 424	2 357	2 443	2 502	1 492
Gearing (Net Debt/ Net Debt + Equity)	39	32	32	62	50	46	54	57	47	61	54	55	68	82	70	31
Debt/EBITDA	1	1	1	3	2	2	3	2	1	2	2	2	2	2	2	1
Solvency Ratio (Equity/Net assets)	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Financial Investments	22	10	205	1 128	537	2 279	2 521	392	464	433	522	632	632			
Free Cash Flow	775	861	1 067	1 208	1 700	n.a	n.a	n.a	1 214	862	1 024	780	1 241	217	870 ⁶	5 486 ⁷
Financial Results	(129)	(99 417)	(55 937)	(53 469)	(170)	(611)	(1 097)	(525)	(274)	(233)	(51)	(107)	(130)	(129)	109	(159)
Net Income	180,8	273,9	349,6	441,1	495	540	307	391	240	623	654	867	742	582	684	5 672
Dividend per share		0,5	0,7	0,9	1,0	0,2	-	0,2	0,2	0,2	0,4	0,5	1,6	0,6	0,6	0,7
Extra Dividend	-	-	-	-	-	-	-	-	-	-	-	-	0,58			1,00

Total Dividend	86,2	85,5	130,8	167,7	191,4	240,4	0,0	125,4	201,0	267,0	395,0	526,4	516,5	533,2	503,6	1379,5
Total Stock Buybacks	na	na	na	na	0,0	0,0	0,0	0,0	196,0	464,0	252,7	85,6	1158,3	904,6	0,0	0,0
Dividend Yield	na	na	na	na	na	na	1,1	2,4	na	3,8	0,0	0,1	6,4	9,5	0,1	25,3
Pay-out Ratio (Total Dividends/Net Income)	47,7	31,2	37,4	38,0	38,7	44,5	40,8	51,3	na	65,5	61,9	82,0	79,5	88,6	73,6	35,5
Share Price (annual $\Delta\%$)	na	na	na	na	39,5	-10,6	-8,4	-25,1	na	14,0	-0,1	0,2	8,6	-32,0	0,4	7,0
PSI 20 (annual $\Delta\%$)	na	na	na	na	na	na	-24,7	-25,6	na	12,6	0,1	29,9	16,3	-51,3	0,3	-10,3

Total Dividends (million EUR)	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	Total
State	62,7	0,0	0,0	0,0	0,0	4,8	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	67,5
Espírito Santo Group	0,0	0,0	0,0	0,0	0,0	23,8	0,0	11,7	19,5	24,6	33,0	40,9	45,4	47,3	40,2	137,3	423,6
Telefónica SGPS	0,0	0,0	0,0	0,0	0,0	9,1	0,0	6,0	0,0	25,9	37,9	52,4	28,2	51,2	50,4	27,9	289,0
Caixa Geral de Depósitos (w/ Fidelidade)	0,0	0,0	0,0	0,0	0,0	1,2	0,0	5,9	0,0	13,4	19,9	26,9	66,8	37,0	36,8	86,4	294,1
Brandes Investment Partners	0,0	0,0	0,0	0,0	0,0	8,9	0,0	6,9	0,0	19,2	33,6	39,0	0,0	52,2	37,9	72,3	270,0
BPI Group	0,0	0,0	0,0	0,0	0,0	7,9	0,0	3,6	0,0	6,7	0,0	0,0	38,2	0,0	0,0	0,0	56,5
Cinveste SGPS	0,0	0,0	0,0	0,0	0,0	0,0	0,0	2,9	0,0	6,4	8,3	0,0	31,3	0,0	0,0	0,0	48,8
Telexpress	0,0	0,0	0,0	0,0	0,0	0,0	0,0	2,3	0,0	5,3	8,1	0,0	0,0	0,0	0,0	0,0	15,7

Capital Group	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	14,4	22,1	0,0	0,0	0,0	0,0	0,0	36,5
Ongoing	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	15,8	22,4	34,2	33,9	0,0	106,4
Fundação Berardo	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	10,9	0,0	0,0	0,0	0,0	10,9
Telfonos Mexico S.A (Telmex)	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	18,0	0,0	13,4	0,0	0,0	31,4
Visabeira Group	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	12,8	10,1	36,4	59,3
Credit Suisse	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	1,2	0,0	0,0	1,2
Barclays	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	10,9	0,0	11,7	12,4	40,6	75,5
Deutsche Bank	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	11,7	0,0	33,9	45,6
Controlinveste Comunicações SGPS SA	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	11,6	10,9	31,5	54,0
Taube Hodson Stonex Partners LLP	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	11,0	0,0	0,0	11,0
UBS AG	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	10,6	0,0	0,0	0,0	27,6	38,2
Fidelity Group	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	5,3	8,3	11,0	0,0	0,0	0,0	0,0	24,6
Paulson & Co	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	12,3	0,0	0,0	0,0	0,0	12,3
RS Holding	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0
Capital Reserach and Management	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	15,0	15,0
The Income Fund of America, Inc	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	69,4	69,4
TPG-Axon Capital Management, LP	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	58,4	58,4
Norges Bank	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	10,1	68,1	78,3
BlackRock Inc.	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	11,8	32,4	44,3

The Royal Bank of Scotland, N.V.	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	30,3	30,3
Europacific Growth Fund	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	27,7	27,7

Source: Annual Accounts. Notes: ¹Increase in net debt due to the acquisition of the Brazilian operation. ²Telesp acquires Global Telesp and other investments in Brazil in the multimedia sector. ³With the contribution of by dividend distribution (€395M) and stock buybacks (€253M). ⁴Increase in debt due to stock buybacks. ⁵With the contribution of stock buybacks (€905M), dividend distribution (€533M) and acquisition of Teleming (€517M). ⁷Selling of the activity in Morocco. ⁸Selling of Brasilcel (€5500M). EBITDA in 1996 and 1997 was obtained by own calculations.

Table Ap. 12 – Portugal Telecom’s investments in the Espírito Santo Financial Group

Year	PT SGPS cash investments at the end of the period			PT SGPS cash investments in securities issued by the Espírito Santo Group		Total exposure to GES	
	Securities	Deposits	Total	Securities BES/GES	Deposits BES	Million €	%
2001	600	111	712	600	-	600	84%
2002	300	860	1160	300	258	558	48%
2003	510	827	1337	510	126	636	48%
2004	560	778	1338	560	104	664	50%
2005	1206	2570	3125	1206	927	2133	68%

2006	506	1004	1511	506	218	724	48%
2007	251	842	1093	251	207	458	42%
2008	-	463	463	-	366	366	79%
2009	-	593	593	-	451	451	76%
2010	400	4592	4992	400	2116	2516	50%
2011	550	3284	3834	550	2301	2851	74%
2012	510	1725	2235	510	1389	1899	85%
2013	750	1105	1855	750	941	1691	91%
2014	897	774	1671	897	746	1643	98%

Source: Ministério Público – Despacho de Acusação NUIPC 122/13.9TELSB. Values in million euros.

Table Ap. 13 – Cimpor’s financial data, 1995 - 2010

Indicators (million EUR)	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Turnover	n.a	n.a	n.a	n.a	n.a	n.a	1 385,7	1 317,2	1 360,9	1 365,6	1 638,9	1 534,9	1 966,1	2 088,9	2 085,5	2 239,4
Net Assets	n.a	n.a	n.a	n.a	n.a	n.a	2 929,1	3 337,9	3 089,2	3 174,5	3 805,4	3 857,8	4 834,0	4 615,3	4 927,4	5 384,9
Equity	n.a	n.a	n.a	n.a	n.a	n.a	1 091,1	949,6	960,6	970,4	1 584,6	1 653,8	1 899,3	1 615,7	1 923,0	2 230,2
Net Debt	n.a	n.a	n.a	n.a	n.a	n.a	1 057,3	1 148,9	1 238,5	1 229,4	1 079,4	865,6	1 359,3	1 862,6	1 698,7	1 561,6
Short-term Debt	n.a	n.a	n.a	n.a	n.a	n.a	570,6	552,4	333,6	156,3	36,5	60,3	623,5	201,5	453,5	934,6
Medium/Long-term Debt	n.a	n.a	n.a	n.a	n.a	n.a	659,4	968,6	1 197,8	1 312,8	1 417,0	1 357,4	1 324,2	1 911,1	1 637,2	1 253,3
juros liquidos	n.a	n.a	n.a	n.a	n.a	n.a	49,2	40,7	(75,9)	(45,3)	(53,7)	(61,0)	(66,3)	(80,0)	(78,2)	(50,7)
EBITDA	n.a	n.a	n.a	n.a	n.a	n.a	504,8	511,4	512,5	458,7	495,8	563,0	607,0	586,3	605,9	629,8
Gearing (Net Debt/ Net Debt + Equity)	n.a	n.a	n.a	n.a	n.a	n.a	0,5	0,5	0,6	0,6	0,4	0,3	0,4	0,5	0,5	0,4
Debt/EBITDA	n.a	n.a	n.a	n.a	n.a	n.a	2,1	2,2	2,4	2,7	2,2	1,5	2,2	3,2	2,8	2,5
Solvency Ratio (Equity/Net assets)	n.a	n.a	n.a	n.a	n.a	n.a	0,4	0,3	0,3	0,3	0,4	0,4	0,4	0,4	0,4	0,4
Net Investment (Goodwill + Fixed Assets)	n.a	n.a	n.a	n.a	n.a	n.a	126,0	116,8	154,0	226,9	160,2	180,6	831,7	590,3	217,6	163,8

Free Cash Flow	n.a	n.a	n.a	n.a	n.a	n.a	n.a	n.a	n.a	106,7	404,1	326,5	-	(283,7)	283,0	248,3
Financial Results	n.a	n.a	n.a	n.a	n.a	n.a	(56,3)	(23,3)	(35,5)	(6,5)	(3,3)	(42,3)	(48,0)	(134,4)	(63,1)	(60,6)
Net Income	n.a	n.a	n.a	n.a	n.a	152,0	137,8	176,6	185,9	185,9	266,2	291,9	304,1	219,4	237,0	241,8
Divident per share	0,36	0,39	0,37	0,50	0,58	0,7	0,7	0,8	0,2	0,2	0,2	0,2	0,2	0,2	0,2	0,2
Stocks 10 ⁶	84	84	84	84	134,4	134,4	134,4	134,4	672	672	672	672	672	672	672	672
Total Dividend	n.a	n.a	n.a	n.a	n.a	n.a	n.a	93,4	107,5	121,0	120,2	127,2		153,2	124,3	133,0
Price	7,73	10,41	15,04	16,99	16,50	26,6	19,7	16,0	4,3	4,2	4,7	6,3	6,0	3,5	5,1	6,4
Capitalisation	n.a.	n.a.	n.a.	n.a.	n.a.		2 6548	2 150,4	2 755,0	2 789,0	3 125,0	4 227,0	4 032,0	2 339,0	4 320,0	3 407,0
Dividend Yield	n.a.	n.a.	n.a.	n.a.	n.a.	2,6	3,6	5,0	4,2	4,3	4,1	3,4	3,8	5,3	3,1	4,0
Pay-out Ratio	52,50	53,20	55,70	56,60	60,90	60,1	68,3	60,9	61,5	65,1	48,0	49,5	50,8	56,7	52,5	55,0
Share Price (annual Δ%)	n.a.	n.a.	n.a.	n.a.	n.a.	61,2	(25,9)	(18,8)	28,1	1,2	12,0	35,3	(4,6)	(42,7)	33,5	(10,3)
PSI 20 (annual Δ%)	n.a.	n.a.	n.a.	n.a.	n.a.	(13,0)	(24,7)	(17,6)	15,8	12,6	13,4	29,9	16,3	(51,3)	84,7	(21,1)
Total Stock Return	10,82	39,72	48,03	16,29	0,53	65,3	(23,3)	(14,7)	(71,8)	(0,2)	16,6	39,9	(1,0)	(38,9)	51,4	30,8
Cummulative Stock Return ¹	47,25	315,66	777,75	971,46	922,94	1 933,5	1 242,6	873,6	1 445,0	1 348,9	1 599,3	2 419,1	2 273,4	1 013,8	1 810,3	2 488,4

Industrial Investment Portugal	n.a.	54,7	39,6	70,5	53,4	28,2	28,5	31,9	18,8	18,0						
Industrial Investment Total	n.a.	181,9	140,6	146,5	118,7	107,7	202,4	269,7	337,7	140,4						
% Total Industrial Investments	n.a.	30,1	28,2	48,1	45,0	26,2	14,1	11,8	5,6	12,8						
Utilisation of installed capacity	n.a.	88,9	82,7	87,1	91,7	89,8	93,2	87,8	63,0	67,5						
EBITDA PT	n.a.	256,8	211,4	176,3	183,0	173,9	172,7	171,9	149,6	139,3						
% Total EBITDA	n.a.	50,2	41,2	38,4	36,9	30,9	28,5	29,3	24,7	22,1						
Turnover PT	n.a.	652,8	554,6	507,4	515,5	462,9	475,9	546,6	448,8	441,4						
% Total Turnover	n.a.	49,6	40,8	37,2	31,5	30,2	24,2	26,2	21,5	19,7						

Dividends (million EUR)	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	Total
Teixeira Duarte Group								29,4	34,5	24,9	27,0	28,7	0,0	35,1	28,3	0,0	207,9
Ladelis (Lafarge)								9,4	13,6	15,2	15,2	16,1	0,0	26,5	21,5	0,0	117,5
Cartera Lusitania S A (Libergeste)								9,0	10,3	0,0	0,0	0,0	0,0	0,0	0,0	0,0	19,4
SECIL - Companhia Geral de Cal e Cimento AS (Secilpar)								8,4	9,7	0,0	0,0	0,0	0,0	0,0	0,0	0,0	18,1
Holcim								9,2	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	9,2
Credit Agricola Lazard								1,9	4,7	0,0	0,0	0,0	0,0	0,0	0,0	0,0	6,5

Pensõesgere								3,9	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	3,9
BCP								4,2	10,8	12,1	12,0	12,8	0,0	15,4	12,5	13,3	93,1	
Seguros e Pensões Gere								2,8	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	2,8	
Cimentos Molins S.A.								2,5	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	2,5	
Credit Suisse First Boston Int.								0,0	0,0	15,2	15,3	16,2	0,0	0,0	0,0	0,0	46,7	
Fundação Berardo								0,0	0,0	10,6	5,3	0,0	0,0	0,0	0,0	0,0	16,0	
HSBC CCF								0,0	0,0	5,3	3,6	3,8	0,0	0,0	0,0	0,0	12,7	
C+PA - Cimentos e Produtos Associados S.A								0,0	4,9	2,2	0,0	0,0	0,0	0,0	0,0	0,0	7,1	
Manuel Fino SGPS (Investfino - investimentos e participações, sgps, Limar Limited e Jevon Limited)								0,0	0,0	13,6	13,6	14,3	0,0	31,0	13,3	14,2	100,0	
Bipadosa (LAF98)								0,0	0,0	0,0	2,4	3,1	0,0	10,2	8,0	0,0	23,7	
CGD								0,0	0,0	0,0	0,0	2,7	0,0	0,0	11,9	12,8	27,4	
Tem Coronel Luis Augusto da Silva								0,0	0,0	0,0	0,0	0,0	0,0	3,2	5,0	0,0	8,2	
Grupo Camargo Correa								0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	43,8	43,8	
Grupo Votorantim								0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	28,2	28,2	
CGD Pension Fund								0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	

Source: Annual Accounts. Note: ¹ Own calculations. In the calculation of cumulative returns, dividends are only considered for t-1.

Table Ap. 14 – EDP's financial data 1997 - 2010

Indicators (million EUR)	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Turnover	n.a	3010,1	3072,0	3846,5	5650,4	6386,6	6296,1	7293,8	9648,2	10349,8	11894,1	13894,1	12198,2	14170,7
Net Assets	n.a	12395,9	13709,6	14886,9	16233,1	18125,2	18650,7	22589,3	24035,6	25468,9	31483,8	35709,1	40261,6	40488,9
Equity	n.a	6127,3	6059,9	6204,7	6096,8	5494,2	5534,5	7202,7	4823,4	5589,2	6264,1	6365,2	7291,2	7854,6
Net Debt	n.a	3470,6	4368,7	5012,4	5799,1	7994,1 ³	7492,7	8598,8	9463,2	9283,1	11692,2	13889,5	14006,6	16344,7
Short-term Debt	n.a	737,0	598,4	1806,6	1744,3	1887,0	1579,1	1857,8	1819,0	1392,0	2441,0	3669,0	2549,0	2737,0
Medium/Long-term Debt	n.a	2733,8	3770,3	3205,3	4054,8	6107,0	5913,6	6741,0	8192,0	8620,0	10129,0	10992,0	13578,0	14938,0
Net Interest	n.a	-153,7	-118,5	-198,3	-235,3	-201,3	-336,5	-324,5	-378,2	-402,2	-539,4	-721,8	-294,8	-336,4
EBITDA	n.a	1712,6	1563,6	1443,1	1454,2	1488,9	1827,0	1968,0	2050,2	2305,5	2628,3	3154,9	3362,9	3612,8
Gearing (Net Debt/ Net Debt + Equity)	n.a	0,36	0,42	0,45	0,49	0,59	0,58	0,54	0,66	0,62	0,65	0,69	0,66	0,68
Debt/EBITDA	n.a	2x	2,7x	3,5x	4x	5,4x	4,1x	4,4x	4,6x	4x	4,5x	4,4x	4,2x	4,5x
Solvency Ratio (Equity/Net assets)	n.a	0,49	0,44	0,42	0,38	0,30	0,30	0,32	0,20	0,22	0,20	0,18	0,18	0,19
Financial Investments (net, stock)	195,5	964,2	1817,6	2729,4	3025,5	1896 ²	1582,8	1615,3	918	1024	957	524	618,4	590,8
Financial Investments (flow)	n.a	na	908,3	1546,9	479,7	1365,7 ¹	-22,5	-24,1	775,7	96,9	1866,9	-1363	-132,6	184,3

Free Cash Flow	n.a	1154,8	1167,6	1217,0	1231,5	1175,4	1302,4	1429,4	1652,8	2017,5	2270,2	1744,5	3921,7	1852,1
Financial Results	n.a	-40,9	-28,2	-35,0	-205,3	-222,9	-359,0	-335,3	-399,3	-207,4	-545,8	-942,7	-487,0	-485,0
Net Income	464,4	522,8	513,9	549,0	450,8	335,2	381,1	440,2	1071,1	940,8	907,3	1212,3	1023,8	1078,9
Op Investments	n.a	1188,6	1532,7	2165,6	1359,6	1480,0	1008,2	1247,4	1427,2	1456,5	2700,2	3618,2 ⁴	3234,7 ⁵	2667,3 ⁶
%Op Investment in PT	n.a	58,4	59,8	86,0	55,1	72,0	67,0	52,2	42,0	38,2	na	na	na	na
% Fixed Assets in PT	n.a	n.a	n.a	n.a	n.a	n.a	77,5	72,1	66,2	55,9	44,1	40,6	22,4	20,8
% Turnover in PT	n.a	n.a	n.a	n.a	n.a	n.a	84,9	75,7	62,2	60,8	60,3	68,7	58,9	54,0
% Net Income in PT	n.a	n.a	n.a	n.a	n.a	n.a	126,4	116,5	45,8	73,0	69,0	64,1	73,3	65,7
Divident per share	0,13	0,14	0,14	0,14	0,113	0,09	0,09	0,092	0,1	0,11	0,125	0,14	0,155	0,17
Stocks (10 ⁶)	3 000,0	3 000,0	3 000,0	3 000,0	3 000,0	3 000,0	3 000,0	3 656,5	3 656,5	3 656,5	3 656,5	3 656,5	3 656,5	3 656,5
Total Dividend	388,6	419,0	419,0	419,0	339,0	270,0	270,0	336,4	365,7	402,2	457,1	511,9	566,8	621,6
Stock Price	3,48	3,75	3,47	3,52	2,44	1,59	2,09	2,23	2,60	3,84	4,47	2,70	3,11	2,49
Capitalisation		11250,0	10298,0	10560,0	7320,0	4770,0	6270,0	8154,1	9507,0	14041,1	16344,7	9854,4	11364,5	9108,4
Dividend Yield	3,7	3,7	4,0	4,0	0,6	5,7	4,3	4,1	3,8	2,9	2,8	5,2	5,0	6,8
Pay-out Ratio	84,0	80,0	82,0	76,0	75,2	80,5	70,8	76,4	34,1	42,8	50,4	42,2	55,4	57,6
Share Price (annual Δ%)	12,0	8,0	-8,0	-2,0	-31,0	-35,0	31,0	11,1	17,0	48,0	16,0	-39,7	15,3	-19,9
PSI 20 (annual Δ%)	20,0	25,0	9,0	-13,0	-25,0	-26,0	16,0	13,0	13,0	30,0	16,0	-51,3	33,5	-10,3

Total Shareholder Return	12,0	12,0	-4,0	6,0	-27,0	-30,0	37,0	16,0	21,0	52,0	19,0	-36,9	20,5	-14,9
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Dividends (million EUR)	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	Total
State	0,0	0,0	192,4	111,4	88,5	70,5	70,5	52,4	74,9	82,4	93,7	104,9	113,6	36,0	1091,19
BCP	0,0	0,0	0,0	21,2	17,2	13,6	13,6	17,1	18,8	18,0	15,5	17,4	17,2	20,9	190,53
CGD	0,0	0,0	20,2	19,9	16,1	12,8	13,1	32,6	17,9	20,1	24,0	26,8	32,1	4,0	239,54
Iberdrola	0,0	0,0	16,8	16,8	13,6	13,5	13,5	19,2	20,8	38,2	43,4	48,6	53,8	42,2	340,41
Brisa	0,0	0,0	0,0	0,0	6,8	5,4	5,4	6,7	7,3	-	-	-	0,0	0,0	31,62
EDP	0,0	0,0	0,0	0,3	1,3	1,6	1,9	1,3	1,7	0,8	1,9	5,0	5,3	5,7	26,82
Caixa Ahorro Asturias (CajAstur)	0,0	0,0	0,0	0,0	0,0	0,0	0,0	19,3	20,2	22,2	25,3	25,6	28,4	31,1	172,27
José de Mello - SGPS	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	8,1	22,8	24,7	27,3	30,0	112,80
BES	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	8,2	10,6	15,6	17,2	16,8	68,50
Pictet Asset Management	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	13,1	14,6	16,2	0,0	43,92
Sonatrach	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	10,2	11,4	12,6	13,9	48,11
International petroleum investment Company	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	10,2	23,0	25,2	58,49
UBS	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	9,7	0,0	0,0	0,0	0,0	9,69

Norges Bank	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	16,5	16,53
Blackrock	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	21,7	0,0	21,71

Source: Annual Accounts. Notes: ¹ Investment in BCP (€168M), Hidrocantabrico operation, and investment in Turbogas. ² Consolidation of Hidrocantabrico. ³ Due to the acquisition of Hidrocantrabico. ^{4,5,6} The increase in operation investment is mostly due to the construction or acquisition of eolic plants abroad, namely in the USA.

Table Ap. 15 – Schemes and modalities of PPP contracts

Build-own-operate (BOO) Build-Develop-operate (BDO) Design-construct-manage-finance (DCMF)	The private sector designs, builds, owns, develops, operates and manages an asset with no obligation to transfer ownership to the government.
Buy-build-operate (BBO) Lease-develop-operate (LDO) Wrap-around addition (WAA)	The private sector buys or leases an existing asset from the government, renovates, modernizes, and/or expands it, and then operates the asset, again with no obligation to transfer ownership back to the government.
Build-operate-transfer (BOT) Build-own-operate-transfer (BOOT) Build-rent-own-transfer (BROT) Build-lease-operate-transfer (BLOT) Build-transfer-operate (BTO)	The private sector designs and builds an asset, operates it, and then transfers it to the government when the operating contract ends, or at some other prespecified time. The private partner may subsequently rent or lease the asset from the government.

Source: IMF (2004, p.22)

Table Ap. 16 – PPP by year, shareholder, investment and NPV

Concession Holder	Shareholder Structure in 2010 or last known	Year	Nº Years	Invest.	NPV Public Pay.	Reneg.
Highways						
Lusoponte S.A.	Grupo Mota Engil (38,0%); Vinci (37,3%); Grupo Somague (17,2%); Grupo Teixeira Duarte (7,5%)	1995	30	867	-	32
Aenor S.A / Ascendi Norte	Grupo Mota Engil (35,1%); Grupo Espírito Santo (19,2%); Grupo Odebrecht (12,9%); Banco Comercial Português (6,7%); Banco Santander Totta (6,7%); Monteadriano (5,4%); Grupo Hagen (5,0%); Mesquita Etvia.(2,7%); Amândio Carvalho (2,7%); Rosas(2,7%);	1999	36	879,2	-	12
A-E Atlantico S.A.	Grupo Brisa (50%); Grupo Lena (25%); Grupo MSF (25%)	1999	30	453,5	-	11
Brisa S.A.	Grupo Brisa (100%)	2000	35	2623,8	-	7

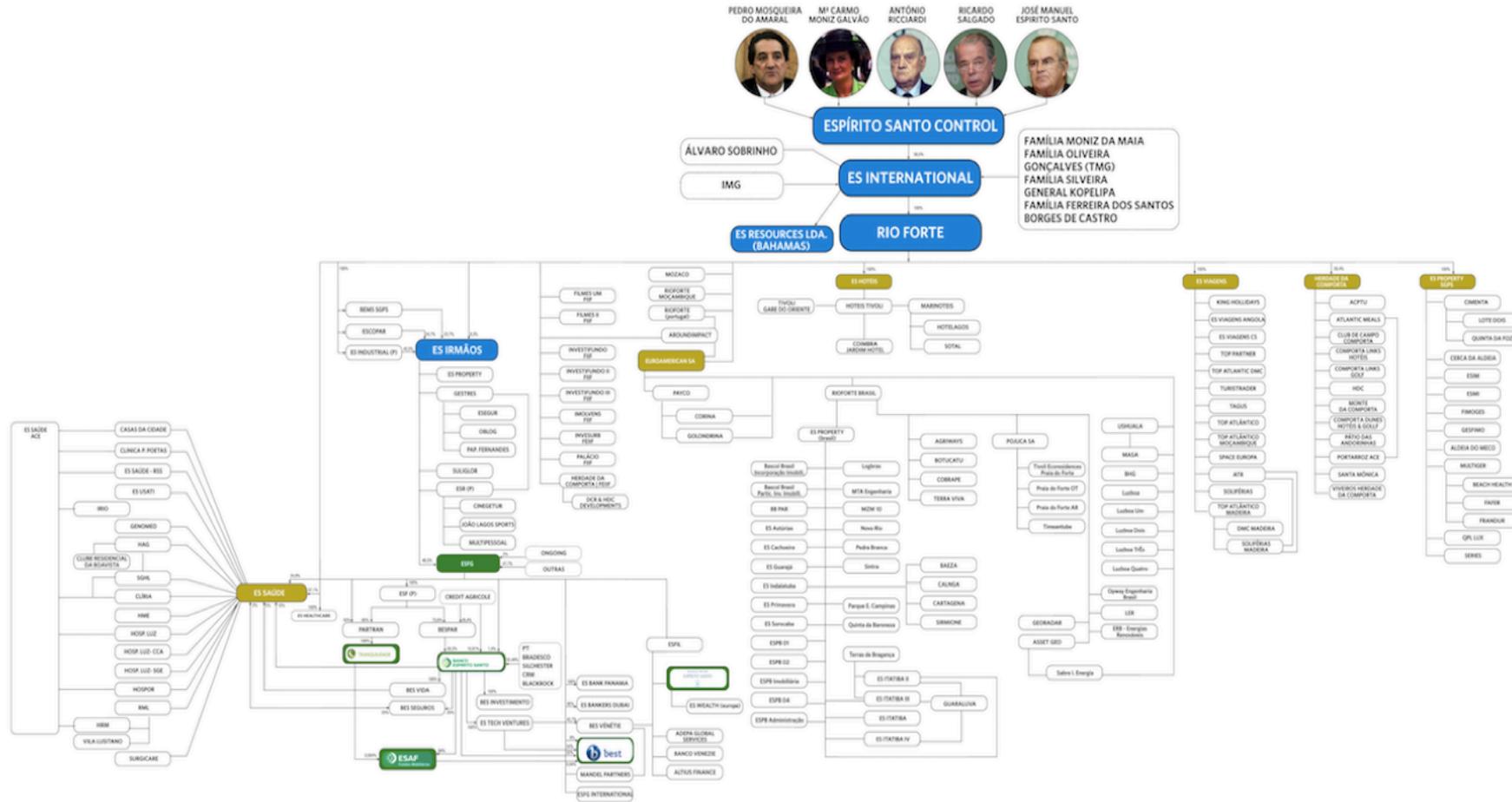
Brisal S.A.:	Grupo Brisa; BCP Investimento; Grupo Somague; Grupo MSF; Grupo Lena; Grupo Novopca.	2004	30	550,7	-	18
ScutVias S.A.	Grupo Soares da Costa(33,3%); Grupo Espirito Santo (22,2%); Global Via Infraestruturas (22,2%), Alves Ribeiro (22,2%)	1999	30	628,3	946	10
LusoScut Costa de Prata S.A./Auto-Estradas da Costa de Prata, S.A.	Grupo Mota-Engil (36,1%); Grupo Espirito Santo (22,4%); Grupo Odebrecht (14,2%); Banco Comercial Português (7,5%); Monteadriano (6,6%); Mesquita Etvia (3,3%); Amândio Carvalho (3,3%); Rosas (3,3%); Grupo Hagen (3,3%)	2000	30	320,7	549	12
EuroScut S.A./ Autoestrada do Algarve - Via do Infante - Sociedade Concessionária - AAVI, S.A	Cintra Concesiones de Infraestructuras de Transporte; Ferrovia Agroman, Construções Gabriel; Couto; Empresa de Construção e Obras públicas de Arnaldo Oliveira; Eusébios & Filhos; Empreiteiros Casais de António Fernandes da Silva; J.Gomes - Sociedade de Construções do Cávado; Aurélio Martins Sobreiro & Filhos; António Alves Quelhas	2000	30	228,5	390	11
NorScut S.A.	Grupo Eiffage (34%); Grupo Sonae (36%); CDC Projects (15%); EGIS S.A. (10%); SEOP (4%); Solusel (1%)	2000	30	504,1	800	3
LusoScut Beiras Litoral e Alta S.A. / Auto-Estradas das Beiras Litoral e Alta, S.A.	Grupo Mota-Engil (36,1%); Grupo Espirito Santo (22,4%); Grupo Odebrecht (14,2%); Banco Comercial Português (7,5%) Monteadriano (6,6%); Mesquita Etvia (3,3%); Amândio Carvalho (3,3%); Rosas (3,3%); Grupo Hagen (3,3%) Grupo Odebrecht (0,0%).	2001	30	718,4	1143	7
EuroScut Norte S.A. / Auto-Estradas Norte Litoral Sociedade Concessionária - AENL, S.A.	Cintra Concesiones de Infraestructuras de Transporte (99,9%)	2001	30	318,6	478	19
LusoScut S.A.	Grupo Mota-Engil (36,1%); Grupo Espirito Santo (22,4%); Odebrecht (14,2%); Banco Comercial Português (7,5%); Monteadriano (6,6%); Grupo hagen (3,3%); Mesquita Etvia (3,3%); Amândio Carvalho (3,3%); Rosas (3,3%)	2002	30	492,5	791	7
LusoLisboa S.A. / Auto-Estradas da Grande Lisboa, S.A.	Grupo Mota Engil (36,1%); Grupo Espirito Santo (22,4%); Grupo Odebrecht (14,2%); Banco Comercial Português (7,5%); Monteadriano (6,6%); Grupo Hagen (3,3%); Mesquita Etvia (3,3%); Amândio Carvalho (3,3%); Rosas (3,3%);	2007	30	180	-	10
AEDL S.A.	Grupo Brisa (45%); Grupo Teixeira Duarte (19,7%); Grupo Alves Ribeiro (13,2%); Zagope (13,2%); Construtora do Tâmega (9%)	2007	27	777,7	-	7
A-E21 S.A. / Auto-Estradas XXI Subconcessionária Transmontana, S.A.	Grupo Soares da Costa 50%; FCC Construcción (2%); Global Via Infraestructuras (46%); Operalia Infraestructuras (1%); Mantenimiento de Infraestructuras (1%)	2008	30	535,9	820	5

Aenor Douro S.A / Estradas do Douro Interior, S.A.	Grupo Mota Engil (46,8%); Banco Espírito Santo (15%) Grupo Espírito Santo (19,8%); Monteadriano (7,7%); Grupo Hagen (3,9%); Empresa de Construções Amândio Carvalho (3,9%); Rosas Construtores (3,9%)	2008	30	641,7	851	5
A-E Marão S.A	Grupo Somague; Grupo MSF	2008	30	348,2	432	4
SPER S.A.	Grupo ACS (49,6%); EDIFER (20%); Conduril (13%); Tecnovia (17,5%) Dragados 0,87	2009	30	381,9	645	30
AEBT S.A.	Grupo Brisa (30%); THIC SICAR (Grupo Brisa + BCP + Compagnie Benjamin de Rothschild) (25%); Grupo Teixeira Duarte (9%); ODB Investimentos em Concessões Rodoviárias (7,9%); Grupo Lena (6,9); Grupo MSF (7,9%); Grupo Zagope (7,9%); Alves Ribeiro (4,5%); Odebrecht (0,0%); Grupo Lena (1%);	2009	30	270,1	935	6
AELO S.A / Auto-Estradas do Litoral Oeste, S.A.	Grupo MSF (32,5%); Grupo Lena (32,5%); THIC SICAR (Grupo Brisa + BCP + Compagnie Benjamin de Rothschild) (20%); Grupo Brisa (15%)	2009	30	443,6	1144	4
Rotas do Algarve Litoral S.A.	Grupo ACS 45%; EDIFER (23%); Conduril (13%); Tecnovia (19%);	2009	30	165,1	539	2
SIEV Sist. Id Elect de Veiculos S.A.		2009	25	n.a.	1665	9
Subtotal Highways			30	12329,5	12128	
Railways						
MTS, S.A.	Joaquim Jerónimo (34%); Grupo Teixeira Duarte (9%); Grupo Mota & Companhia (9%); Grupo Engil (9%); SOPOL (6,8%); Siemens 21,3%; Meci - Montagens Eléctricas Civis e Industriais S.A. (10,7%)	2001	30	268,7	0	5
Fertagus, S.A.	Grupo Barraqueiro	1999	11 + 9	900	53	4
Subtotal Railway			30	1168,7	53	
Health						
LCS S.A.		2006	4+3	4	39	1
GP Saúde		2006	7	3	33	0
Escala Braga, Gestora do Edifício S.A.	Grupo Somague (51%); Grupo José de Mello (42%); Grupo Edifer (15%)	2009	30	122	137	0
Escala Braga Gestora do Estabelecimento S.A.	Grupo José de Mello (99,9%); Grupo Somague (0,0%)	2009	10	11,3	693	0
HPP Saúde - Parceria Cascais, S.A.	Fidelidade Mundial (75%); USP Hospitales Portugal (25%)	2008	10	16	285	0
TDHOSP, S.A	Teixeira Duarte S.A. (100%)	2008	30	56	99	0
SGHL - Soc Gestora do Hospital de Loures S.A.	Grupo Espírito Santo (97,9%); Hospital de Arrábida-Gaia, (1%); Clíria - Hospital Privado de Aveiro (1%)	2009	10	29,3	478	0

HL - Sociedade Gestora do Edifício S.A.	Grupo Mota-Engil (50%); Grupo Espírito Santo (41%) Dalkia - Energia e Serviços (9%)	2009	30	84,6	155	0
Escala Vila Franca – Gest. do Estabelecimento, S.A.	Grupo José de Mello; Grupo Somague	2010	10		372	0
Escala Vila Franca - Gestora do Edifício, S.A.	Grupo Somague; Edifer; Quadrante Engenharia e Consultoria	2010	30		134	0
Subtotal Health			20	319,2	2425	
Security						
SIRESP - Redes digitais de Seg. e Emergência	Motorola (14,9%); Portugal Telecom (30,6%); Galilei (33%); Datacomp - Sistemas de Informática (9,6%); Grupo Espírito Santo (12%)	2002	20	112	307	1
Subtotal Security			20	112	307	
				13929,4	14913	

Source: Based on Saemento and Renneboog (2015), UTAP Reports and PPP contracts. NPV – Net Present Value (dated 2015).

Figure Ap. 2 – Grupo Espírito Santo: corporate structure in 2014



Source: Own elaboration based on official documents from the archives of the Parliamentary Inquiry Committee. Note: This structure refers to 2014, after a restructuring operation in which Rioforte became the main shareholder of Espírito Santo Financial Group (ESFG). In the previous structure, the Group was divided in two arms, one of the financial holdings, centered around ES Irmãos and ESFG, and one, non-financial, around ES Resources and Rioforte.

Table Ap. 17 – Largest construction companies by revenue 2000-2007

Company	2000	2001	2002	2003	2004	2005	2006	2007
Mota Engil	547.038	868.840	876.107	1.005.327	1.168.635	1.381.001	1.308.233	1.401.900
Teixeira Duarte	380.716	412.696	402.979	734.542	705.027	696.537	755.859	1.011.513
Somague	417.226	476.055	735.365	838.314	835.042	746.119	661.651	669.200
Soares da Costa	294.627	330.572	376.919	559.272	589.400	553.772	562.296	550.541
Opway	95.143	114.267	113.926	166.470	255.954	296.768	295.186	535.230

Source: Thames (2008).